

**FRAMEWORK FOR THE DEVELOPMENT OF
NATIONAL SHIPPING POLICIES**



**ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND
THE PACIFIC**

**FRAMEWORK FOR THE
DEVELOPMENT OF NATIONAL
SHIPPING POLICIES**



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PREFACE

Framework for the development of national shipping policies

The developing countries in the Asia-Pacific region have over the last decade achieved a high degree of economic growth. This has been accompanied by a rapid increase in overseas trade much of which is carried by sea. As this century comes to a close, nine out of the 20 top container carrier are from Asia. These top slots however are limited to a few countries in the region, and the disparity between the success stories and the shipping services of the majority of the developing countries is very wide. The reasons for this widening gap between the major players and the rest are many and varied. While developing countries wish to maintain a presence in shipping, the shipping industry has not been afforded a high priority within the industrial development of these countries. The emphasis has been on visible items of trade rather than on services including the shipping sector.

Countries in the region have since of late recognized that shipping services are an important element of their economic growth and that unless concerted action is taken, national shipping services would be marginalized in the face of global competition. Countries in the ESCAP region face a dilemma. On the one hand they want to maintain a presence through the development of national shipping capabilities. On the other hand they want the trade to enjoy the competitive shipping services, offered by overseas shipping lines. The reconciliation of these issues require that national maritime administrations evaluate the shipping potential of the country and formulate appropriate shipping policies.

Policy development requires detailed knowledge of the international and regional maritime environment and policy tools and options. The experiences of developed maritime countries and the policies adopted by countries in the region could be an important starting point.

With this in view ESCAP undertook a project to assist countries in the region to develop their national shipping policies. The project aimed to develop a frame work that would provide policy makers with the background information and the policy tools and options that are required for successful formulation of shipping policies. In implementing the project an extensive survey and analysis has been carried out on the shipping policies of selected ESCAP countries through questionnaires, country papers and country visits. The analysis is contained in the frame work document which gradually introduces the policy makers to the complex subject of shipping policy development from a practical standpoint.

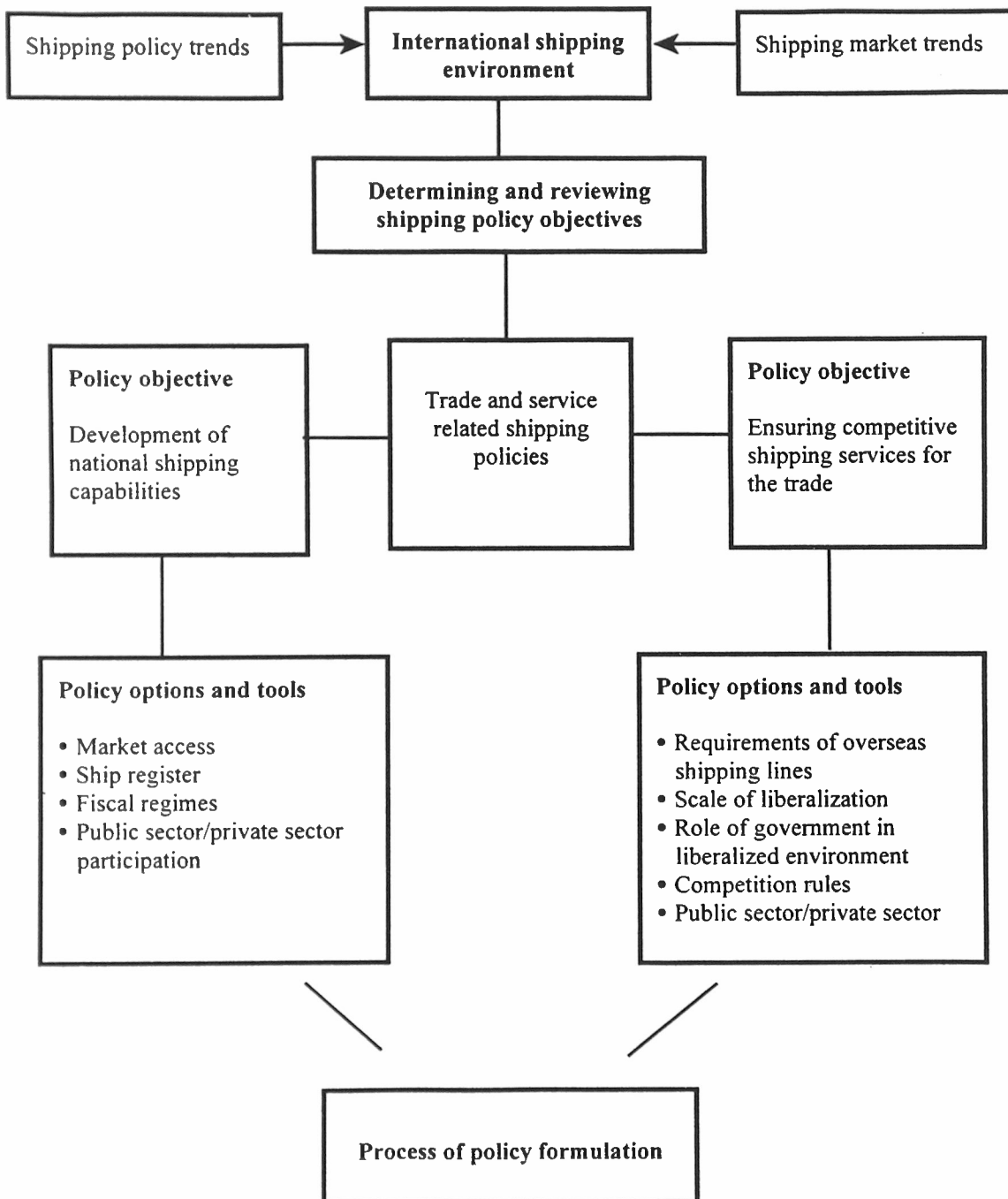
Each country has to work out its policies in the overall context of national economic objectives and its shipping potential. A policy that is appropriate for one country may not be appropriate for another. The issues to consider however, are similar and the framework that is contained herein should assist policy makers to make informed decisions on a range of subjects pertaining to trade and services related shipping policies.

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CHAPTER 1: OVERVIEW

National policies relating to shipping can cover a wide variety of maritime related topics. Such policies are inter connected and should be viewed in the context of general transport policy and should facilitate the attainment of national economic objectives.

The scope of the national shipping policies, the process of policy formulation, its enumeration and direction is the prerogative of each country. No country can however develop shipping policies in isolation. The myriad of regional and international influences have to be carefully analyzed if national shipping policies are to be developed on a sound basis.

The focus of this publication is trade and service related shipping policies. It sets out issues that should be considered by policy makers in determining national shipping policies and provides a framework and the tools to analyze and deliberate such issues.

National shipping policies can cover a wide range of maritime activities such as shipowning, operating, seafaring and related activities, ports and infrastructure. All these activities are inter-related and may be grouped together in one maritime transport policy or separate shipping and ports policies. The shipping policies would revolve around a set of objectives directed at developing the shipping industry.

Shipping policies can be broad objectives at a *macro economic level*. On the other hand, they can relate to more detailed policy objectives at a *micro economic level*. It is also possible and desirable that the policies address the question of implementation, i.e. strategies to achieve the objectives and the institutional and legal framework required for implementation. Addressing these issues at the outset gives credibility to the policies and avoids creating a “wish list”. Inclusion of strategies which will indicate how policy objectives will be achieved, will also demonstrate the political commitment of the Government to implement strategies and thereby provide stakeholder confidence and a favourable climate for investment.

The disadvantages of including the strategies along with the policies is the time and resources that would be required to formulate detailed strategies, and the inflexibility that it may bring. Policy makers thus have to achieve a balance between the need for certainty and the need to provide the flexibility to respond to the changing shipping scene.

This publication covers aspects of shipowning and operating from the perspective of international trade, the focus being on trade and service related shipping policies.

Access to adequate and competitive shipping services, underpins the ability of a country to participate in global markets and is therefore pivotal to economic growth. Policies relating to shipping are thus closely linked to a country's ability to achieve its overall economic objectives.

The objectives of trade and services related shipping policies could be to promote and expand the country's foreign trade by ensuring the free and increased availability of shipping services and competitive freight rates, or component of this may be to maintain a shipping presence by developing national shipping capabilities. Alternatively, a country may choose to promote the development of its national shipping capabilities as its primary objective through the support and promotion of the national merchant fleet in the face of foreign competition. On the other hand a country may decide that its trade is best served by competitive overseas shipping lines and choose to establish its presence through the development of national NVOCC's and national logistics service providers. The policies of a government with regard to the provision of commercial shipping services may have conflicting objectives or may be in conflict with interests and objectives of its trading partners or of the shipping interests of other countries.

The development of service related shipping policies must take into account a number of complex factors.

Shipping being a derived demand is dependent on trade and is closely tied to international economics, having to adapt and accommodate changing trade patterns and technologies

The international shipping market is relatively unregulated (unlike the aviation industry) and is extremely competitive.

Shipping is a cyclical market and is subject to drastic swings in supply and demand (as seen during the recent downturn in the Asian economies).

The 1970's saw the developing countries establish national shipping lines which they hoped would assist in the carriage and diversification of external trade and improve the balance of payment position. The shipping policies of these countries revolved around the development and promotion of the fledgling shipping fleets. Over the years countries in the region have amended these policies in an ad hoc manner. They are however becoming increasingly aware of the need for pro active review of the policies and the institutional and legislative structures that are currently in place. Countries in the region are also aware of the need to formulate comprehensive shipping policies which would respond to the challenges of the new millennium.

The formulation of national shipping policies requires a detailed knowledge of the international shipping environment and an understanding of policy tools and measures. An examination of the experience of other maritime countries in the use of various policy tools can be an important starting point in the process of policy formulation.

Objective and scope of the policy framework

The ESCAP secretariat has carried out an in-depth survey and study aimed at developing a framework to assist policy makers to review and formulate trade and service related shipping policies. The shipping policy framework contained in this document is the result of this study.

The following chapters focus on the overall policy objective of facilitating adequate, reliable, efficient, and competitive shipping services. In formulating shipping policies that would achieve this overall objective government and industry have to consider the trade outlook of the country and the developments that are taking place in seaborne trade around them, as well as the capacities and competitiveness of the national fleet.

The liberalization of shipping that has swept through the region and pressure from the world trade organization (WTO) to further liberalize trade in services brings into focus the fact that the objective of promoting competitive shipping services to carry the country's trade may be at variance with the objective of promoting national fleet development.

Countries in the region thus face a dilemma. On the one hand they wish to ensure that the trade enjoys competitive shipping services which may be offered by overseas shipping lines offering ever increasing economies of scale and perhaps more sophisticated services. On the other hand they wish to develop national shipping capabilities and other related industry sectors.

Shipping policies differ from country to country depending on the state of economic development, the nature of international trade, the maritime heritage and the political philosophy of the government. Established maritime countries which export extensive shipping services seek to retain their presence in world seaborne trade. Developing countries seek ways to maintain a shipping presence and carry a share of their trade by further developing their own shipping capabilities.

Despite the difference in the rationales for development, there is some common ground between the developed and developing countries in recognizing the critical factor of competitiveness. Advanced maritime countries are exploring means to increase competitiveness through economies of scale and optimizing the benefits of market liberalization. Developing countries seek measures that would improve their competitive advantages which include relatively low wage structures and opportunities created from greater trade expansion in the region.

This framework does not engage in a debate on the merits of the shipping policies of individual countries. An extensive analysis has however been undertaken of the experience of countries in the Asia Pacific region, and as well as other key maritime nations in developing this policy framework and guidelines. The analysis is based mainly on original data obtained through questionnaires, country papers, written by resource persons in selected countries, personal interviews with relevant authorities, as well as inputs from consultants and ESCAP secretariat staff.

The primary objectives of this framework is to help national governments, policy makers and the shipping industry, in the Asia Pacific region to *inter alia*,

- Assess the global shipping environment including shipping market trends and shipping policy trends.
- Provide an insight into the factors that should be considered in formulating shipping policies.
- Address the process of policy formulation and the options available to the government.

-
- Determine a vision for the maritime sector including the range of attainable objectives which will contribute to national economic development.
 - Examine the strategies and tools available to achieve the shipping policy objectives.
 - Identify the institutional and legal framework that would have to be put in place to implement policies that are formulated.

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CHAPTER 2: INTERNATIONAL SHIPPING ENVIRONMENT

Shipping is a derived demand and is influenced by forces that effect trade including globalization and liberalization. National shipping policies have to take into account the current international shipping market trends and shipping policy trends.

- *What is globalization in the context of shipping?*
- *What is the impact of liberalization on shipping markets?*
- *What are the emerging shipping market trends?*
- *What are the recent trends in shipping policy?*
- *How will the multilateral trading systems of the WTO affect the maritime sector of ESCAP countries?*

Shipping and world sea borne trade

Shipping is an economic activity undertaken within an environment of global trade. The demand for shipping services will thus be sensitive to changing patterns of trade and economic activity. In a free market, freight rates would be determined by market forces and would depend on demand and supply. Although on the demand side there has been a steady annual growth of overall sea-borne trade, on the supply side, investment in shipbuilding has contributed to an oversupply of ships in the liner, bulk and tanker markets. The increase in tonnage has brought pressure on freight rates forcing shipping lines all over the world to seek greater levels of efficiency. A desire to achieve greater economies of scale, particularly in the liner shipping industry has seen a remarkable increase in the size and capacity of container vessels and new vessels with a capacity of 6,600 TEU have come on stream.

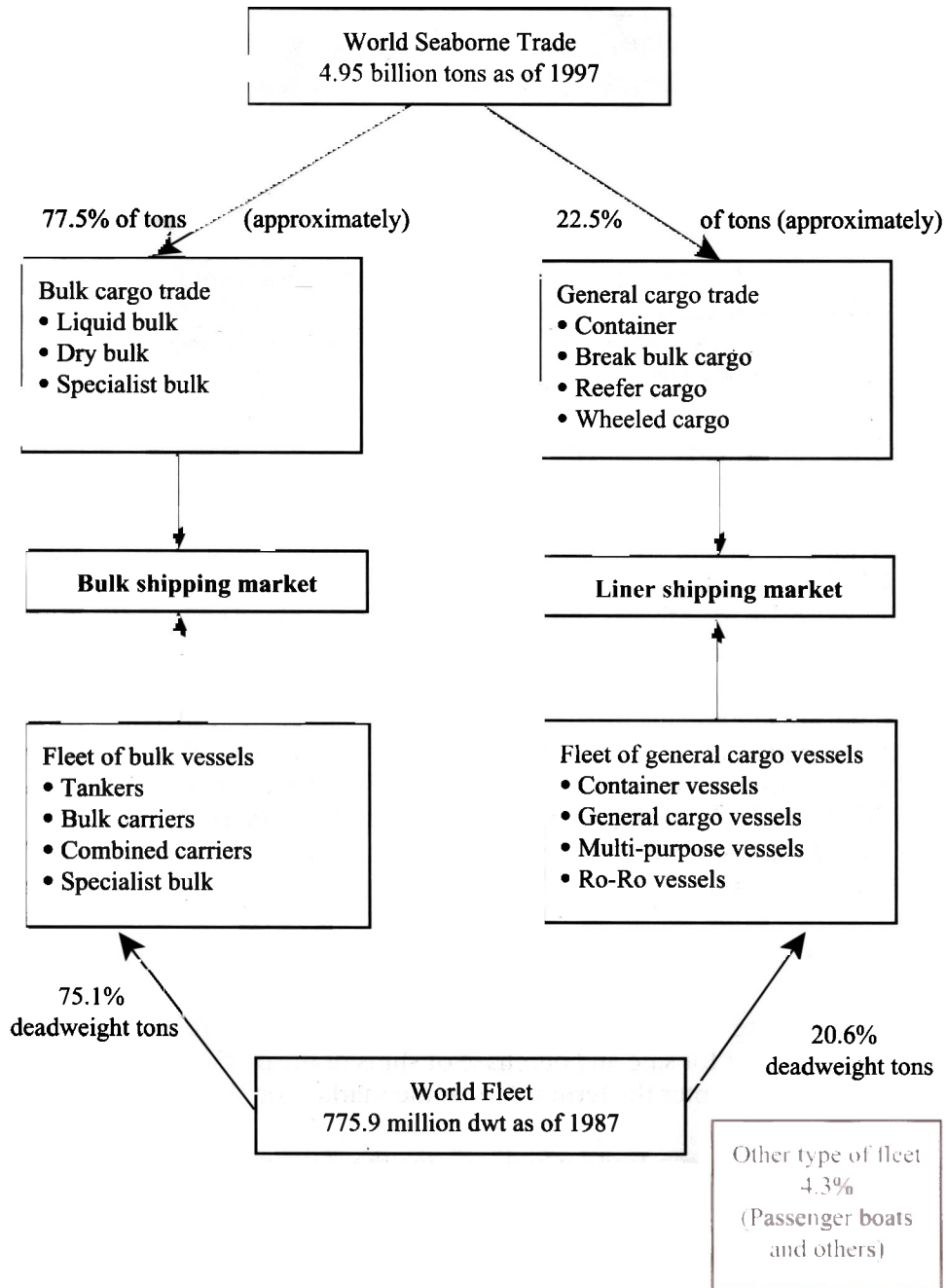
Shipping markets

“Shipping markets” could refer to several markets related to shipping, such as the market for sale and purchase of ships or the market for the chartering of ships. In this chapter the term refers to the market for shipping services.

World seaborne trade which creates the demand for shipping services stood at 4.95 billion in 1997. Bulk cargo constitutes by far the largest percentage of world seaborne trade with approximately 77.5% of total tons carried. General cargo constitutes the remaining approximately 22.5%.¹

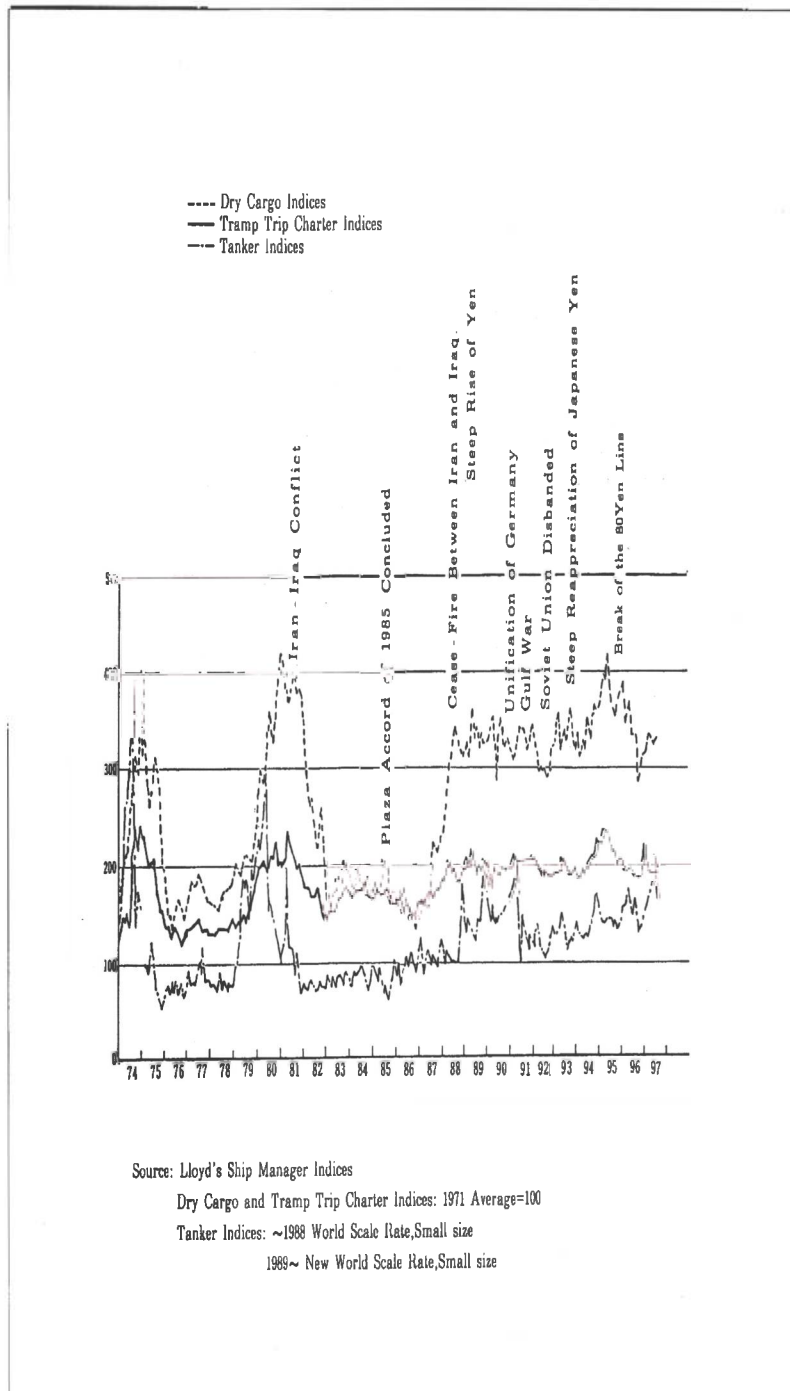
UNCTAD Review of Maritime Transport (1998) page 6. Also note that there is a slight difference in the tonnage recorded as goods loaded (4,953 million) and goods unloaded (5,037 million).

Figure 2.1: Relationship between World Seaborne Trade and World Fleet



Source: Based on UNCTAD 1998 Review of Maritime Transport

Trends of freight rates from 1974 to 1997 are shown in figure 2.2



Dry bulk and tanker markets

Bulk and tanker trades are subject to free market conditions, and information on cargo and freight rates are offered to prospective players in this market through a network of brokers operating through out the world. Due to the well established second hand market it is relatively easy for newcomers to join this market provided they can raise the funds required to buy or charter second hand tonnage. The bulk and tanker sector is not short of entrepreneurs who enter the market with the intent of making a quick return on the investment. The active second hand market, coupled with new buildings which are now manufactured in a shortened period of time has resulted in over tonnaging and depressed freight rates. The low level of freight puts pressure on shipowners to extend the life of ships. It is observed that the average age of a bulk carrier is 14 years, while the average age of a container carrier is 10 years.

Cargo movements of four bulk cargoes, namely, crude oil, coal, iron ore, and grain are shown in figure 2.3.

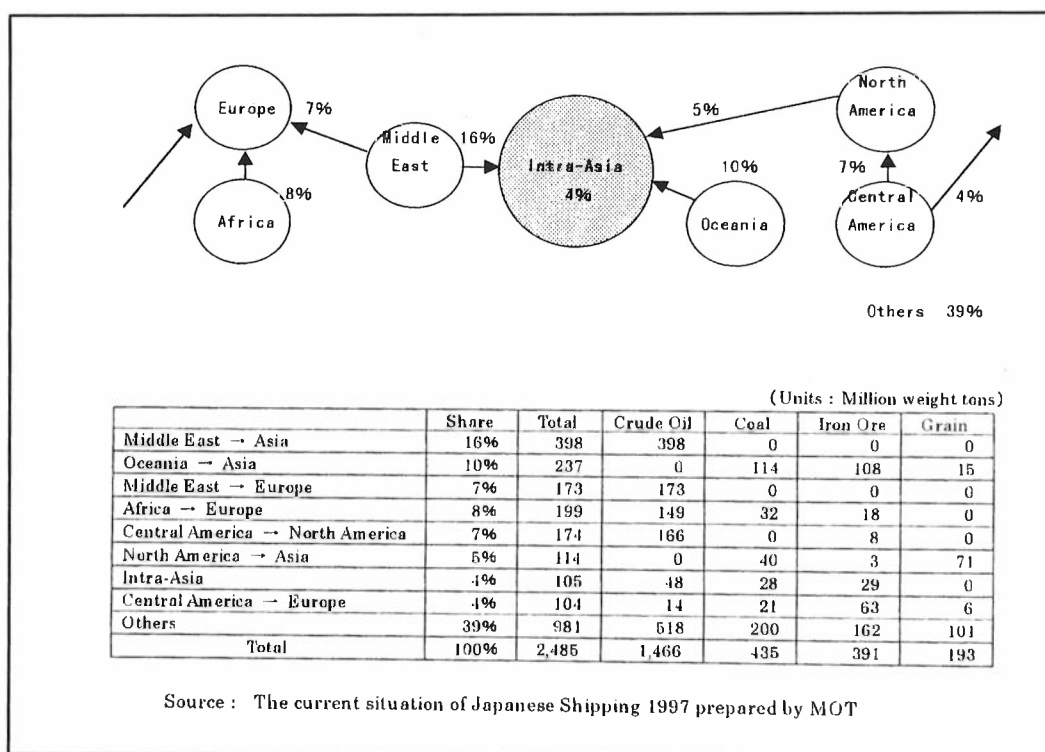


Figure 2.3: World bulk trades by area (1996)

Liner shipping markets

Liner shipping services operate on fixed itineraries or regular schedules at established rates available to all shippers. The freight rates which are charged are based on the shipping company's tariff or if the company is a member of a liner conference, the tariff of that conference. A liner ship would thus carry an assortment of goods, in large or small quantities, belonging to a number of shippers, in identifiable lots, on advertised routes, destined to a single or to multiple ports, at fixed intervals, on a fixed tariff, with mark and count.

Liner shipping bears high network costs and tends to be more capital intensive than bulk shipping. The routing and scheduling challenge in container shipping is also quite different to that of bulk shipping.

Liner conferences which have been an essential feature of liner shipping services have been subject to change due to multilateral instruments, regulatory regimes, structural change in the industry and market forces. With the advent of container transport and development of intermodalism the liner shipping market has structured into a single global market. In the process of restructuring, liner shipping companies have devised various forms of horizontal and vertical operative agreements amongst them and accelerated their business concentration.

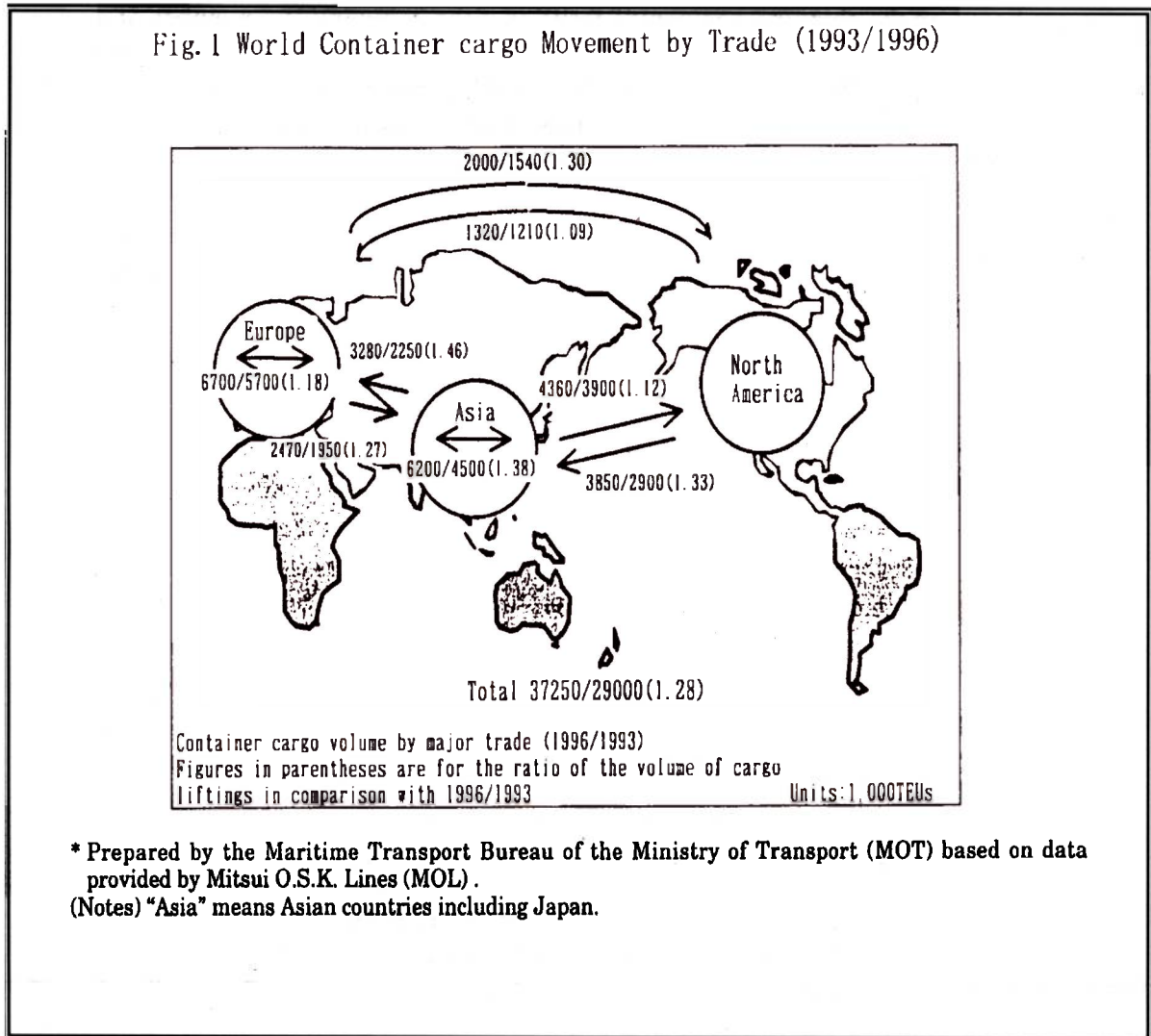
Growth in liner trade

The explosive economic growth which has prevailed since the mid 1980's has led to the growth of exports and imports of manufactured goods between Asia and the European and North American countries and within the Asian region itself.

This expansion of demand for transport to and from Asian countries and within the Asian region, has given rise to a vast Asian - related shipping market, and an unprecedented growth in container traffic.

Figure 2.4 illustrates how world container movements have grown between 1993 and 1996.

Figure 2.4: World Container Cargo Movement by trade (1993-1996)



Intra-Asian trade links have developed dramatically over the last decade, and in 1996 more than half of Asia's trade was intra-regional. Global carriers have accordingly increased their presence in these markets. In 1998, nine² of the world top twenty carriers were from Asia as shown in Table 2.1. The deployment of post-panamax vessels between 4,000-6,000 TEU have provided opportunities for economies of scale.

APL not reflected as Asian carrier in spite of purchase by NOL.

Table 2.1: The World's Top 20 Carriers' Containership Capacity in Operation

End of 1985			September, 1998		
Ranking	Carriers	TEU	Ranking	Carriers	TEU
1	Evergreen	84,116	1	Maersk	346,123
2	USL	71,219	2	Evergreen / Uniglory	280,237
3	Maersk	56,151	3	P&O Nedlloyd	250,858
4	Sea-Land	46,917	4	MSC	220,745
5	Hapag-Lloyd	39,154	5	Hanjin -includes DSR-Senator	213,081
6	OCL	36,266	6	Sea-Land	211,358
7	NYK	35,164	7	COSCO	202,094
8	OOCL	34,084	8	APL	201,075
9	K-Line	28,964	9	NYK / Tokyo Senpaku	163,930
10	APL	27,396	10	MOL	133,681
11	MOL	27,353	11	Hyundai	116,644
12	COSCO	24,940	12	ZIM	111,293
13	Nedlloyd	23,916	13	CP Ships	105,322
14	UASC	23,862	14	CMA-CGM	91,600
15	CGM	23,454	15	Hapag-Lloyd	90,879
16	ZIM	20,282	16	OOCL	90,063
17	YMIC	20,086	17	K-Line	89,717
18	Wilhelmsen	19,624	18	Yangming	79,840
19	Baltic	18,371	19	UASC	59,331
20	NOL	15,803	20	SCL	55,584
TOTAL		677,122	TOTAL		3,113,455

New developments in trade and shipping

Until a few years ago economists referred to growth in “international trade” They now refer to growth in “global trade”. Are these then different concepts? The term ‘international trade’ is increasingly used to refer to trade between two countries. The term ‘Global trade’ is an extension of the term ‘international trade’ where the market place is no longer perceived to be two overseas countries but the entire world i.e. the global market place. Is this a new phenomenon or is it a new way of looking at an old scenario. Perhaps it is a little of both. Three factors have assisted in the creation of the global market place: liberalization of trade, technology of communication and modern transport.

In order to understand the new developments in the shipping sector, in the presence of increasing global trade, it is necessary to reflect on the nature of modern international production and distribution. The following scenarios may help to convey the essence of globalization in the context of production and distribution.

Cotton picked by Pakistani villagers is shipped in break bulk form to factories in Japan for processing. The bales of cloth are then shipped in containers to garment manufacture in Fiji. The finished garments are shipped back to the fashion markets in Japan and Europe.

Cashew nuts harvested mechanically in Western Australia are partly processed locally and then shipped to China to complete the labour intensive process of removing the outer layer of the cashew nut. The cashew nuts are then shipped back to Australia for further processing, packaging and distribution to overseas markets.

Components for television sets manufactured by Japanese companies located in Malaysia are produced partly in Japan and partly in Malaysia. The components produced in Japan are shipped to Malaysia and the television sets are assembled in Malaysia. The television sets are finally shipped to markets in Asia, USA and Europe.

Vegetables picked in the evening in Harare, using appropriate technology are on supermarket shelves in London the next morning. The appropriate technology in this instance is hand picking by villagers. Liberalization of trade enables the exporters from Harare to access the UK vegetable market. The Boeing takes the place of the old steamer, and orders are transmitted to the village through the new technology of the fax and the phone. New opportunities, and new terms that reflect these opportunities.³

The above examples highlight the fact that manufacturers and producers seek comparative advantages to sell their products in the global market. Comparative advantages are subject to change. Pakistan may choose to develop its ability to process the cotton and “value add” to its exports. Japanese buyers may then decide to arrange the shipment of cloth directly from Pakistan to Fiji, thus cutting out a link in the transport chain. Australian farmers seek new

3 Paul Krugman; *The Accidental Theorist*, P. 85; Penguin Group 1999. Krugman elaborates this example in his discussion on the driving forces behind globalization.

technology to remove the husk from the cashew nut and may have no need to first ship the product to China. If the labour costs in Malaysia increase beyond a point Japanese companies would seek to re-locate their industry in a new location. Transport patterns would have to follow these changing trends in production and distribution.

Structural change in the liner shipping markets

Globalization of production has led to the creation of a demand for competitive global transport services. Shippers are becoming highly conscious of the benefits of logistic management on a global scale. Shippers now require a service that would ensure the right product in the right place, at the right time with one operator assuming responsibility for the door-to-door service. Shippers have thus begun to build partnerships with reliable carriers who can provide global transport networks. Leading liner carriers therefore have no option but to develop business strategies to expand their service network to meet the changing needs of the market place and offer a fixed day/weekly service at a global level.

To cope with the intense competition, and provide the frequency and scope of services required by shippers, liner shipping companies have devised various forms of horizontal and vertical integration with each other.

Table 2.2: Top six alliances

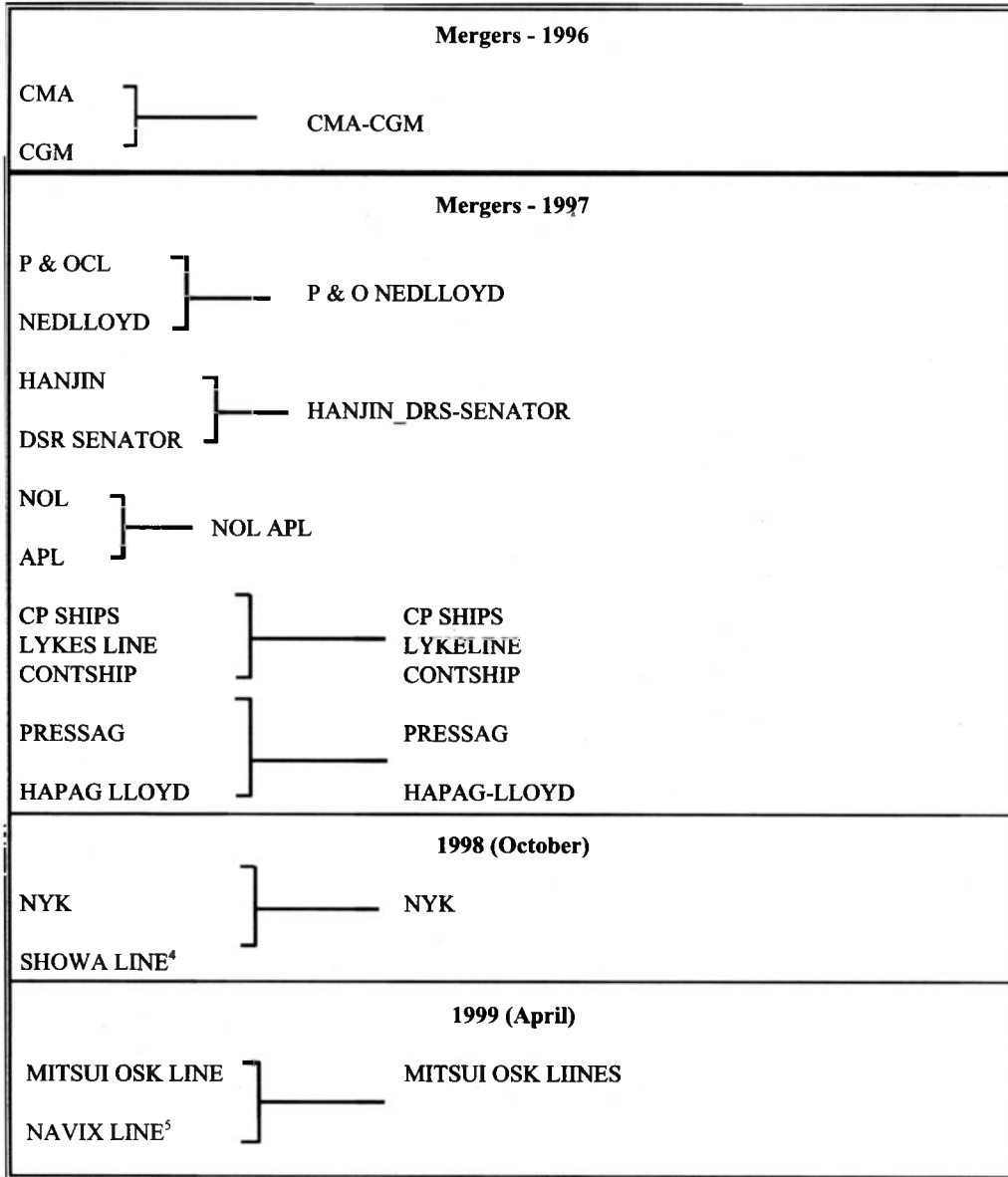
TRADE	Pacific		Asia/Med		N Europe		TOTAL	
	Loops Ships	Trop(1) Trop/Ship	Loops Ships	Trop Trop/Ship	Loops Ships	Trop Trop/Ship	Loops Ships	Trop Trop/Ship
Grand (2)	5 29	17,180 592	2 13	5,900 454	5 40	28,000 520	15 95.5	54,000 565
New World (3)	9 53.5	33,730 630	1 8	2,370 297	3 24	13,750 573	14 89.5	52,000 581
United Alliance (4)	8 49	26,400 539	1 7	2,700 386	3 23	11,500 502	14 89	46,050 517
MaerskSeaLand	5 29	16,100 555	1 5	4,068 814	2 18	9,120 506	12 67.5	43,080 638
KLine								
Yangming								
Cosco	6 34	19,900 585	0 0		3 25	9,440 378	10 63	31,640 502
Evergreen	4 26	13,830 532	1 8	2,730 341	2 15	6,045 403	8 55	26,520 482
TOTALS	37 220.5	127,140 577	6 41	17,768 433	18 145	77,855 488	73 459.5	253,290 551

Total includes alliance participation in Atlantic trades not shown here.
(1) Trop: Teu revenue opportunity per week one way. Trop/Ship is Trop per ship.
(2) Grand Alliance: HapagLloyd, Malaysian International SC, NYK, OOCL and PO Nedlloyd
(3) New World Alliance: Hyundai, MOL and Neptune Orient/API
(4) United Alliance: Hanjin, DSRSenator, Cho Yang and UASC
Source Lloyd's List Maritime Asia February 1998

Vertical cooperative agreements in the form of global alliances are also being formed by individual carriers of different nationalities for the purpose of strengthening their marketing activities, including sales networking and value added services. Each carrier belonging to a particular alliance may have the flexibility to make further alliances so as to further expand its activities on a global basis.

Mergers between leading shipping lines which commenced around 1996, heightened in 1997 with a total of five merges and has tapered of in 1998 and 1999.

Table 2.3: Mergers from 1996-1999



⁴ Japanese bulk & tanker carrier

⁵ Japanese bulk & tanker carrier

For developing country shipping companies that wish to enter or continue to provide liner shipping services, the emergence of global carriers has meant increasingly strong competition. Inability to invest in capital intensive container shipping and the provision of extensive market networks may result in developing country shipping lines losing their traditional role in all but niche markets.

The impact of the Asian economic crisis on liner shipping

The economic turmoil that has been affecting the Asian region since July 1997 has resulted in the following:

depreciation of currencies;
weakening of economies;
sharp reduction in asset value;
erosion of investor confidence

This economic contagion effecting the region and in particular Southeast Asia, is different to other economic cycles that have been experienced in the past. The current economic crisis has adversely affected all countries in one way or another. The crisis which first hit Thailand and then spread to Indonesia, South Korea, and other Southeast Asian countries, have also affected the rest of the world.

Until the middle of 1997, Asia was the fastest growing region in the world. With freer trade opening up of world markets to South East Asian goods, and the growth and expansion of export oriented industries, Southeast Asia was for several years, the most dynamic and prosperous region in the world. Southeast Asia was also a good market for the products of other countries. The economic crisis and the rapid depreciation of currency however has had the effect of drastically reducing, within months, the wealth of Southeast Asia, that had taken a decade to achieve. It has also taken away important export markets from the rest of the world. Introduction of budgetary restraint as part of austere fiscal measures, has led to the cancellation or postponement of infrastructure projects. The worlds richest nations now at different stages of the economic cycle, from a gloomy Japan, to a recovering Europe, and a buoyant United States, find themselves facing a slowdown in the global economy at a time when they need a growing world market into which they can export. It is evident that the turmoil in the Asian economies has had a direct and indirect effect on the demand for shipping services.

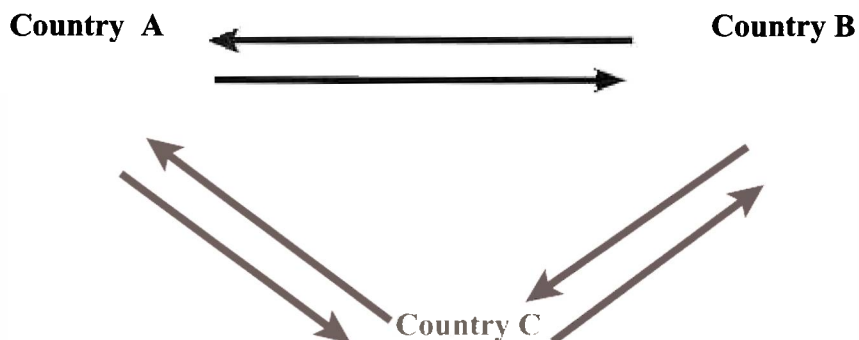
The short-term consequences in countries which have experienced currency depreciation has been a surge in exports creating serious imbalances in trade flows and equipment requirements beyond anything carriers had envisioned. Shipping lines have been forced to alter vessel schedules and make special arrangements to reposition empty containers to meet demand. Repositioning has become an increasingly serious problem for major shipping lines, particularly in countries such as Indonesia, which have been hardest hit by the regions economic woes.

In the long term, the price advantage of exports from Southeast Asia may not last as currencies adjust themselves and the cost of components of manufactured/assembled goods increase. Nevertheless it is anticipated that as the economies of Southeast Asia recover, the demand for shipping services to and from Asia as well as within Asia will continue to grow. There is already optimism of a strong export led recovery in some of the countries which were worst affected such as Thailand, Malaysia, Philippines and South Korea.

Shipping Policy Trends

Liberalization vs protectionism

Liberalization aims at free trade and services on the basis of non-discriminating commercial principles. Statistical links have been drawn between free trade and economic growth. The economic rationale for free trade is that all countries have assets, whether they be human, industrial, natural, financial, which could be used to produce goods and services for the domestic or overseas market. Economic activity is generated and thus economic benefit is derived when these goods and services are traded. For countries to be able to trade overseas, they have to take advantage of their assets in concentrating on what they can produce best and trade this product (s) with other counties for different products. Economists refer to this as the comparative advantage of countries.



Liberal trade policies not only help exporters and importers of goods but also provide opportunities for those involved in the transport of goods.

Liberalization through the removal of tariff and non tariff barriers to trade may of course have the immediate result of a flood of imports which are more competitive than the domestic products with adverse repercussion on some domestic industries. Over a period of time however the 'open economy' and market access should help domestic industries to become competitive in the manufacture and trade in some other commodities. Market forces alone may not be sufficient for industries affected by competitive imports to survive the onslaught and find niche markets. Governments thus have an important role to play in ensuring the gradual liberalization of markets and in helping domestic industries to find new areas to grow into. Fledgling industries may also require fiscal and other support measures.

Protectionism aims at safeguarding the trade and services of a country by preventing or restricting the entry of overseas goods and services through discriminatory measures.

The shipping sector has a strong history of protectionism and in the past countries have adopted direct and indirect protectionist measures to establish, develop and sustain their national shipping industry. With some exceptions most obvious and direct protectionist measures have been adopted by the developing countries. These measures have to be viewed in its historical context.

Historical perspective - the advent of protectionism

A national merchant shipping fleet has traditionally been considered important by countries for strategic purposes in that the ships could be requisitioned in times of strife to ensure that essential trade could go on as usual. A shipping fleet has also been considered important to carry the import and export trade of a country and assist in the movement of domestic trade.

When one examines the development of shipping fleets in a global sense, the mid twentieth century was characterized by the traditional maritime countries possessing large fleets while the newly emerging countries strived to establish fleets of their own. With a few notable exceptions such as India and some countries in Latin America, such as Brazil and Chile, which had been striving to promote the development of a national fleet or had a long tradition of national shipping, by the 1950's and 1960's the shipping industry in the developing countries was dominated by the traditional maritime powers.

During the 1950's and 1960's the developing countries began examining the economic systems which they had inherited from the colonial powers. They quickly observed that they were operating under a system in which economic activity was substantially or exclusively geared to the production of primary commodities. The commodities were then sold in the markets of the developed countries in exchange for manufactured consumer and capital goods. Many colonies were also heavily dependent on foreign supplies of essential food stuff and petroleum products.

For countries that were so heavily dependent on foreign trade, the adequacy of shipping services was an important consideration. The newly emerging countries recognized the need to diversify their export commodities and saw the importance of establishing their own shipping lines.

When the national lines of the developing countries attempted to access the cargo generated by the foreign trade of their countries however, they found that this was not possible due to the trade routes being dominated by liner shipping conferences controlled by foreign shipping lines. As these conferences were "closed" conferences, the new national lines could gain membership of the conference only with the approval of the existing member lines. Such approval was not forthcoming and the new national lines found themselves in the position of not being able to operate in their own market.

Multilateral instruments such as the United Nations Code of Conduct for Liner Conferences (UN Liner Code), bilateral shipping agreements which sought to divide the trade between two groups of shipping lines on a 50-50 basis and unilateral cargo reservation measures practiced by developing countries in the 1970's and the early 1980's have to be understood in the above context.

The adoption of the UN Liner code in 1974 appears to have encouraged the interventionist policy of developing countries. Although the U.N. Liner Code did not come into force for 10 years after its adoption, its existence seems to have indicated an endorsement of measures designed towards cargo sharing. Thus after 1974, many countries adopted legislation which provided for liner cargoes to be distributed between respective groups of national lines and third country lines on a 40:40:20 basis. Some countries established freight booking offices to implement this principle. Liner Conferences and the international liner shipping industry in general sought to accommodate these legislative and administrative measures as part of a new international economic order in liner shipping.

Towards liberalization of shipping

Ironically, the coming into force of the U.N. Liner code in 1983 saw a marked change in climate towards protectionism in maritime services. The developed countries of Western Europe whose ratification brought the Convention into force made clear reservations or declarations that the code should only apply to liner conference cargo and not to all liner cargo. Developed countries also stated that measures taken by developing countries to restrain access to cargo which were not in conformity with the Convention would give rise to retaliatory action.

The EEC, (now EU) and its member governments also exerted diplomatic pressure on developing country governments to abandon their restrictive regulations on access to cargo. Similar pressure was exerted by the Federal Maritime Commission of the United States of America, including the use of penalties to persuade trading partners in Latin America to move away from bilateralism and open their trades to third country carriers.

There were also several domestic factors within developing countries that accelerated the pace of liberalization of shipping as there was a recognition that:

- Cargo reservation schemes were restricting the shipping opportunities available to exporters and hampering the expansion of exports and imports.
- Relatively high freight rates charged by national shipping lines operating in a protected market was adding to the cost of exports and imports.
- National shipping lines were not being subject to the forces of outside competition and technological change and therefore became outmoded and operationally inefficient.
- In many cases national shipping lines which were state owned were running at a loss and required subsidies instead of being a revenue earner for the state.

It was a combination of these international and national factors that led to the dismantling of the cargo reservation policies of the developing countries in the early nineties.

Liberalization of shipping must, however, also be seen in the context of the wave of economic liberalization that has been sweeping across the developing world. Frustration caused by long years of inadequate development, the worsening terms of trade and the disillusionment with socialist policies brought about in countries political change which favoured private enterprise. This has led to a market oriented and deregulated approach to development, with the state seeking to increasingly withdraw from the direct operation of economic enterprise.

In the long-term, a liberal and global trade regime will be to the benefit of all countries. Active participation of all countries in the WTO and the development of common policies will help to ensure that liberalization takes place at a pace that is acceptable to developing countries in the ESCAP region.

The World Trade Organization (WTO)

The World Trade Organization (WTO) was created in January 1995 as a result of the final round of the General Agreement on Tariffs and Trade (GATT), otherwise known as the Uruguay round with the participation of 111 countries. GATT was an international agreement formulated in 1947 to facilitate multilateral trade negotiations. It was supported by an ad hoc international agency which was set up later.

One of the main objectives and in fact its main achievement has been the opening up of markets. GATT was organized as a series of trade talks, or rounds, and the Uruguay round (the 8th round) included non-tariff barriers, trade in goods (particularly agricultural goods) and trade in services. Earlier trade rounds dealt mainly with the reduction of tariffs.

The WTO which replaced GATT is a full fledged international Organization with a permanent secretariat administering three major agreements, including the GATT.

WTO
International Organization
+
Agreements

- **GATT:** General Agreement on Trade and Tariff
- **GATS:** General Agreement on Trade in Service
- **TRIPS:** Agreement on Trade Related Intellectual Property Rights

International trade in goods arise where a product is transported from one country to another. This is an easy idea to understand. International trade in services is a little more difficult to conceptualize as it refers to the buying and selling of services between different countries. The rules that apply to one type of service may not be applicable to another type of service. Banks, shipping lines, airlines, accounting firms, telecommunication firms are all engaged in serving overseas markets. The diversity of services offered are recognized in that annexes to the GATS deal with different services.

The General Agreement on Trade in Services (GATS) is the first set of multilateral, legally enforceable rules covering international trade in services and has several components.

- General principles and obligations of countries, in the main text
- Rules for specific sectors in the annexes
- Individual countries specific commitments to provide access to their markets
- Lists where countries are temporarily not applying the “most favoured nation principle”

Most favoured nation treatment (MFN)⁶

Favour one, favour all. MFN means treating one’s trading partners equally. Under GATS, if a country allows foreign competition in a sector, equal opportunities in that sector should be given to service providers from all other WTO members. MFN applies to all services, but some special temporary exemptions have been allowed.

<http://www.wto.org/wto/about/facts2.htm>

MFN exemptions: temporary and one-off ⁷

WTO members have also made separate lists of exception to the MFN principle of non-discrimination. When GATS came into force, a number of countries already had preferential agreements in services that they had signed with trading partners, either bi-laterally or in small groups. WTO members felt it was necessary to maintain these preferences temporarily. They gave themselves the right to continue giving more favourable treatment to particular countries in particular service activities by listing MFN exemptions alongside their first set of commitments. In order to protect the general MFN principle, the exemptions could only be made once; nothing can be added to the lists. They will be reviewed after five years (in 2000) and will normally last no more than 10 years. The exemption lists are also part of the GATS agreement.

GATS cover all services including maritime services. The maritime sector is an important service and the openness of such services are considered important for the development of world trade and for which multilateral trade disciplines⁸ have to be formulated. GATS is a powerful instrument which will exercise pressure for progressive liberalization of all trade in services including shipping.

Negotiations conducted by WTO to include a specific chapter on the liberalization of services in the maritime sector however failed due to the reluctance of the major players to agree to a multilateral instrument. The USA wished to continue bi lateral negotiations and unilateral sanctions. Under the circumstances negotiations relating to the liberalization of shipping services were suspended in June 1996, to be resumed in the year 2000. The negotiating group has identified three main areas where rules will have to be developed: Access to and use of port facilities, auxiliary services, and ocean transport. The rationale behind the WTO efforts to liberalize maritime services is based on the premise that open markets will benefit participating nations through greater business

<http://www.wto.org/wto/about/facts.2.htm>

⁸ See further <http://www.wto.org/wto/about/facts.1.htm>. The output of the WTO or the way in which it operates is often referred to as “multilateral trading systems”. The term “multilateral” is used in stead of “global or world” to describe the system because although almost all the main trading nations are members of the WTO, some are not. So multilateral refers to activities on a global or near global level. It contrasts with actions taken regionally or by other smaller groups of countries.

opportunities. Agreement on a set of international competition rules could play a central role in the GATS on shipping. The WTO system forbids unilateral action and has a dispute settlement mechanism to examine trade rows, issue verdicts, and monitor whether countries comply with their international obligations.

The framework: GATS articles

Basic principles:

- All services are covered
- Most favoured nation treatment in areas where commitments made
- Transparency in regulations
- Regulations have to be objective and reasonable
- Internal payments: normally unrestricted
- Individual countries commitments: negotiated and bound
- Progressive liberalization: through further negotiation

The WTO has more than 134 members accounting for over 90% of world trade, while 30 others are negotiating membership. The over riding objective of the WTO is to help trade flow smoothly, freely, fairly and predictably. It is the only international organization dealing with global rules of trade between nations. These rules contained in the WTO agreements and known as the multilateral trading system⁹, are negotiated and adopted by member states and later ratified by them. They become the legal ground rules for international commerce and governments have to keep their trade policies within agreed limits. On the other hand the rules guarantee member countries important trade rights.

The rationale behind the WTO efforts to liberalize shipping services is based on the premise that open markets will benefit participating nations through greater business opportunities. A specific chapter on shipping in the General Agreements in Trade in services of the WTO could result in a multilateral instrument that ensures free markets and fair competition. Agreement on a set of international competition standards could thus play a central role in the GATS on shipping.

⁹ See further <http://www.wto.org/wto/about/facts.1.htm>

Once the negotiations relating to the maritime sector resumes in the year 2000, all governments will have the right to participate in the discussions and provide an input. It is therefore important that governments in the ESCAP region understand the way in which the WTO negotiations are carried out. It is also important that Governments in the region review their shipping policies to determine the market access provided to overseas service providers and the extent to which they wish to liberalize the shipping and port sector.

The WTO is conscious of the fact that over three - quarters of its members are developing countries or least developed countries and special provisions are included in all WTO agreements.

The special provisions include the following:

- Longer time periods for implementing agreements and commitments
- Measures to increase trading opportunities
- Provisions requiring all WTO members to safeguard the trading interests of developing countries
- Support to help developing countries build the infrastructure for WTO work, handle disputes, and implement technical standards.

Organization for Economic Co-operation and Development (OECD)

Shipping has been one of the main concerns of the OECD from its inception in 1947. The OECD has always sought to defend the principles of liberalization and the code of liberalization of current invisible operations (called the Code) of 12 December 1961 affirmed this. The Code has become a successful example in promoting liberalization. The OECD's activities relating to the shipping industries are conducted through the Maritime Transport Committee (MTC) whose functions mainly relate to the exchange of views, consultation and cooperation.

In 1987, the OECD agreed to a series of principles and guidelines amongst member states on the following:

- common principles of shipping policy for member countries; and
- liberalization of current invisible operations relating to maritime transport.

The main body of the recommendations were based on four elements:

The maintenance of open trade and free competitive access to international shipping operations;

Coordinated response to external pressure, based on full consultation between member countries;

Active opposition to regimes which restrict access to cargo (moving internationally) by shipping companies adhering to the principle of free competition on a commercial basis;

A common approach to the application of competition policy in the shipping sector.

These elements embodied in 12 principles formed a new and coherent, common approach to international shipping policy between OECD member countries and their relations with countries outside the organization.

In the 1987 guidelines the developed market economy countries had for the first time, a detailed document covering a large number of aspects of international maritime transport, which could be used as a yardstick for national policies. The recommendations and resolutions were essentially aimed at preserving and encouraging the freedom of world-wide seaborne trade.

Problems relating to shipping policies between OECD member and non-member countries usually arise due to protectionist pressures from developing countries. Conflict among member countries are caused by different approaches towards the regulation of liner conferences, restrictions upon free access to specific types of cargo and by the different fiscal regimes to promote the development of national fleets.

The European Union (EU)

The maritime policy direction of the European Union (EU) is contained in the paper issued in 1996 titled "Towards a New Maritime Strategy". Although the paper only has the status of a communication at present, it will no doubt be one of the main instruments in the development of shipping policy within the EU.

The main components of the new Maritime Strategy of the EU relate to the following areas:

Maintaining open markets

Safeguard free access and fair competitive conditions throughout the global shipping market.

Acting against market access barriers.

Acting against unfair competition.

Forging international agreement on the application of competition principles in maritime transport.

Safety

Increased port state control through operational links with other third countries.

Increase responsibility placed on the cargo owner to use quality vessels and operators.

A safety policy based on internationally agreed rules.

Common rules for community ship registers.

Competitiveness of the EU shipping sector

Promote maritime training programmes to attract young people to the profession.

Foster maritime Research and Development (R&D) including high technology in safety and environmental protection and human resources.

Allowing greater individuality to member states to develop individual solutions in terms of favourable corporate tax schemes, relief on personal tax and social security payments to encourage use of EU crews and promotion of maritime R&D.

The port state control measures emphasize and encourage the use of quality vessels and operators. The proposed policy also suggests that strong support for a free market with free competition should go together with measures to regulate markets and support schemes to be developed by individual

governments to make European shipping companies more competitive. The implementation of these policies will be observed by all maritime nations and will have an impact on the shipping policies being developed by other countries.

The United States of America (USA)

The United States of America (USA) is the largest market place in the world. The carriage of its foreign trade is open to commercial competition from both national and foreign shipping companies. The United States of America advocates principles of free and fair competition in international shipping and is opposed to cargo sharing agreements. The open nature of its shipping markets go a long way in establishing “the free market” as an important principle in international shipping policy. In practice, however, there are areas where shipping policies and strategies of the USA do not appear to match the ideology and principles of the free market.

The basic principles of the United States of America shipping policy is to achieve the following objectives:

Increase the competitiveness of shipping serving its international trade.

Enhance the competitiveness of its national fleet to serve the interests of consumers by providing low cost and efficient shipping services.

Maintenance of a national merchant fleet able to meet national security needs.

Competitiveness of shipping services

The policy of ensuring competitiveness which applies to all industries has been implemented in the United States of America through a series of legislative enactments being with the Sherman Act of 1890¹⁰. This main anti-trust legislation which forbids the restriction of trade contains the following important principles:

¹⁰ “Antitrust Laws” refer to the Act of July 2, 1890, as amended; the Act of October 15, 1914, as amended; the Federal Trade Commission Act as amended, Sections 73 and 74 of the Act of August 27, 1894, as amended; the Act of June 19, 1936, as amended, the Antitrust Civil Process Act, as amended and amendments and Acts supplementary thereto [section 3, OSRA 1998, USA].

Contracts/agreements/understandings between two or more persons/companies restricting free competition in the market are illegal;

Monopolizing of trade is prohibited.

The structural organization of the shipping industry with its monopolistic tendencies, particularly the liner conference system, required special provisions having to be made for the shipping sector. This has been done over the years through several Shipping Acts - the Shipping Act of 1916 and 1984, and most recently the Ocean Shipping Reform Act of 1998.

The Shipping Act of 1984 and the new Ocean Shipping Reform Act of 1998 provide a good insight into development of trade and service related shipping policies in the United States of America. The Shipping Act of 1984 contained three policy declarations:

To establish a non-discriminatory regulatory process for liner services to and from the United States with a minimum of governmental intervention and regulation;

To provide an efficient and economic transportation system that is in so far as possible in harmony with and responsive to international shipping practices;

To encourage the development of an economically sound and efficient United States - flag liner fleet capable of meeting national security needs.

The Shipping Act of 1984 retained many of the provisions of the 1916 Act, but included changes which facilitated approval of the conference agreements and broadened the anti-trust exemption that approval bestows. Among the changes applicable to the conference system, broadening of carriers' anti-trust immunity, intermodal authority, mandatory independent action (I/A) and service contracts (S/C) were the most significant. The impact of the Act has been far reaching in the liner shipping industry, particularly on the structure of the industry's organization, rate levels, and its competitive environment.

The practical impact of the Shipping Act of 1984 is briefly discussed below:

The simplified approval procedure relating to agreements enabled carriers to enter into cooperative agreements between themselves more easily. This led to the filing of agreements between conference lines as well as between conference lines and independent lines to be filed with the Federal Maritime Commission (FMC).

Rates and terms of services have become the contractual agreements between individual carriers and shippers. These are known as independent action (I/A) or service contracts (S/C). Thus the negotiating power of the shippers has been enhanced.

In this regard, the two following points are worthy of note:

A conference agreement must provide that any member of the conference may take independent action on any rate or service item required to be filed with FMC; e.g. an individual rate may be agreed upon with a shipper.

Service contracts between conference (carriers) and shippers have been authorized. A service contract contains a commitment by the shipper to provide a minimum quantity of cargo over a fixed time period, and the other party commits himself to a certain rate (or rate schedule) and a certain service level.

The Act authorized various forms of cooperative arrangements like joint service/consortium agreements as well as sailing and space charter agreements.

The Act triggered rate reductions in trades through numerous offers of independent action or service contracts to shippers and thus has undermined the collective strength of shipping conferences.

When one of the conference lines eager to increase its market share took independent action (I/A) to set rates lower than the conference, tariff rates, all the remaining lines had no option but to follow suit to match or undercut the rates. This tendency has exerted downward pressure on freight levels.

The powers of the FMC have been broadened in order that it could take counter measures in case of discrimination of United States Flag vessels. The following are two examples:

The FMC and the Trans-Atlantic Conference Agreement (TACA) agreed to a settlement of the proceedings against the conference.

The FMC opened an investigation into port restrictions and requirements in Japan concerning the prior consultation system of mandatory discussions and approval of shipping operations in 1995. A fine was imposed on three major Japanese shipowners in 1997.

The most significant contribution of the Shipping Act of 1984 has been to facilitate the creation of new types of agreement among carriers and to clarify the scope of carriers' anti-trust immunity and ensure its predictability.

Debates bringing about substantial change to the Act has been going on since 1992 and the Ocean Shipping Reform Act of 1998 (OSRA) was introduced in October 1998. The Act came into force on 1st May 1999.

The OSRA brings in a further policy objectives as follows: "To promote the growth and development of US exports through competitive and efficient ocean transportation and by placing a greater reliance on the market place".

The ocean-shipping business will be largely deregulated, setting off a scramble among shipping lines to lure customers with discounts of rates. Container shipping lines for the first time will be able to sign individual, confidential contracts with importers and exporters. The competition to sign up such customers is expected to greatly loosen the grip of the shipping conferences that have legally set rates for ocean shipping for more than a century.

Main changes of the Act would be as follows:

Shipping conferences will not be allowed to hamper the negotiation of service contracts which are the contractual arrangements between individual carriers and shippers.

(The reason is that shippers prefer to deal with individual lines rather than conferences because they are reluctant to reveal commercially sensitive information to a group of carriers. They prefer to develop a long-term partnership with selected carriers to minimize the risk of disclosing sensitive information to their competitors).

With regard to service contracts and agreements, the FMC would require information relating to five aspects only. These relate to the origin and destination port ranges, the commodity, minimum volume and the duration of the voyage.

Shippers and carriers would thus no longer have to disclose essential terms of service contracts and agreements such as line haul rate and service commitments.

Through amendment to Section 19 of the Merchant marine Act of 1920, the FMC will have the right to investigate and take action against foreign carriers on pricing practices employed by owners, operators, agents or masters of vessels of a foreign country.

The regulatory powers of the FMC have always been a matter of great interest to all countries involved in shipping. The role and powers of the FMC was subject to debate in 1995 with the introduction of the Ocean Reform Bill. The bill sought to abolish the FMC and transfer some of its functions to the Department of Transportation. This issue appears to have died a natural death and the regulatory powers of the FMC are in fact being strengthened.

Measures to develop national merchant fleets

The United States of America shipping policy is characterized by its commitment to the principles of free trade and services and objection to protectionist measures. Its policy to maintain an adequate national merchant marine, however, is supported by strategies which use subsidies and cargo preference schemes directed at the national shipping fleets. This inconsistency is the result of the dilemma which is faced not only by the United States of America but all countries. The developing countries in the ESCAP region have acknowledged if not the ideology, at least the practical advantages of free trade and the need for competitive shipping services provided by overseas shipping lines. On the other hand, countries in the region also wish to develop their national shipping capabilities. The rationale for the development of a national merchant marine in the United States of America is primarily defence oriented. The rationale for the development of national fleets by the developing countries include factors other than defence. Developing countries have seen through experience that the presence of a national merchant fleet gives rise to other related industries. They also wish to maintain a presence in the carriage of foreign trade generated by the country. These are legitimate interests and the tangible and intangible costs of furthering these interests should be assessed.

The strategies adopted by the United States of America, may provide countries in the ESCAP region with some models that could be used in the development of their own shipping policies.

The basic elements of the United States of America subsidy programme consist of Constructional Differential Subsidy (CDS) and Operating Differential Subsidy (ODS) introduced in 1937.

Fiscal support measures

Constructional Differential Subsidy (CDS)

CDS was aimed at developing the shipping industry as well as the shipbuilding industry. An American shipping company which intends to build a vessel for the purpose of operating in foreign trade was able to obtain a CDS subsidy for the construction price at an American yard. The purpose of the CDS was to cover the difference between possibly higher construction costs at an American yard compared with costs of a foreign yard.

The CDS was an important instrument for the development of the shipping industry up to the fiscal year 1981 but has since been suspended due to the policies of budgetary constraint.

Operating Differential Subsidy (ODS)

This regime is granted to some United States of America flagged vessels operating in the carriage of essential foreign trade, to place US-flag vessels' operating costs on parity with those of foreign competitors. Subsidy is paid pursuant to 20-year ODS contracts between the United States of America Government and the operators, who agree to equip their vessels with defence-related features and also to make their vessels available in time of national emergency.

In the 60 year period between 1937-1997, the aggregate amount of subsidies provided to United States of America flag operators have exceeded US\$ 10 billion.

Maritime Security Programme (MSP)

The MSP established in 1996 provides operating assistance to United States of America flag liner vessels serving in foreign trade on the condition that the participating carriers provide intermodal sealift support in time of war and national emergency. The 10 year programme can provide funding of up to US\$ 100 million annually.

Table 2.3: Maritime Security Programme Participants

American President Lines, Ltd.	9 containerships
Central Gulf Lines, Inc.	1 LASH (barge carrying ship) 2 roll-on/roll-off vessels
Crowley Maritime Corp.	3 container/roll-on roll-off vessels
First American Bulk Carrier Corp.	2 containerships
Farrell Lines Incorporated	3 containerships
Lykes Bros. Steamship Co., Inc.	3 containerships
Maersk Line, Ltd.	4 containerships
OSG Car Carriers, Inc.	1 roll-on/roll-off vessel
Sea-Land Service, Inc.	15 containerships
Waterman Steamship Corp.	4 LASH
Total	47 vessels

(Source: MARAD 1997 Annual Report)

MSP is expected to be gradually replace the ODS when it expires.

Cargo preference schemes

Shipping policies in the United States of America have traditionally utilized cargo preference/ reservation schemes to support the national fleet. The schemes relate to cargoes that are directly or indirectly financed and generated by the government. This means that only a minor part of the seaborne transport of the United States of America's foreign trade is covered by preferential legislation. The present system of cargo preferences can be divided into the following three types:

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- (i) Preference for United States vessels in the carriage of various forms of Government financed cargoes and Alaskan Crude oil.

The Cargo Preference Act of 1904, the Cargo Preference Act of 1954 and the Public Resolution 17 of the 73rd U.S. Congress provide the legislation for the preference of United States of America vessels for government financed cargoes .

With regard to the carriage of Alaskan crude oil, the preference of United States of America vessels is contained in one of the clauses in the instrument that lifted the ban on the export of Alaskan crude oil in 1995.

The case of the Alaskan crude oil amounts to the introduction of a new cargo reservation policy and is a major departure from the establishment of free shipping markets. The OECD has expressed concern over this policy which is in clear conflict with OECD common practice on shipping. The OECD common practice is based on the policy of freedom in shipping and prohibits preferential treatment of vessels registered in one's own country.

The United States of America policy also appears to contravene the negotiations on maritime transport services contained in the declaration of the WTO Marrakesh Ministerial Conference in April 1994. The decision states that no government should adopt any measures that may affect trade in maritime transport services while the WTO negotiations (through NGMTS) are suspended.

Item No. 7 of the decision requires that member countries should refrain from any measures that would affect trade in maritime transport services, unless the measures were in response to measures applied by other countries or directed at improving the freedom of maritime transport services. The decision also precludes governments from adopting measures that would improve their negotiating position and leverage.

- (ii) Bilateral cargo sharing agreements: the bilateral maritime agreements with the People's Republic of China, provides for parity in the carriage of bilateral liner cargo. These agreements which cover import and export of commercial cargoes are directed to ensure that the vessels of each nation carry at least one-third of such cargoes.

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- (iii) Coastal trade is exclusively reserved for American built, American manned and American crewed vessels (cabotage).

Recent trends in shipping policy

The international focus on liberalization and the establishment of the WTO will have a profound effect on shipping policies being developed by countries in this region. The international shipping environment is subject to rapid changes and shipping companies are locked in an intense internationally competitive business environment.

The shipping market has become global. Global carriers are constantly restructuring the shipping market according to their business strategies. They are the market shapers.

The liner shipping conferences which operated between specific trade routes between groups of countries have weakened. The dispute settlement machinery which was effective in balancing the relationship between liner conferences and the exporters and importers appears to be no longer applicable to the global carriers and alliances. Countries in the ESCAP region must thus give serious thought whether the dispute settlement mechanism, should move from the national arena to a global forum such as the WTO.

Some of the recent trends in shipping policy are noted below.

- **Deregulation and liberalization**

Countries have eased regulations on private shipping companies participation in the carriage of overseas trade and have made provision for the following:

allow foreign carriers access to carry overseas trade;

transform a licensing system of sea going vessels/operators to a filing system;

review regulations and practices applying to the provision of shipping services and bring them in accordance with international practices.

Removal/relaxation of restrictions on foreign investment

Restriction on foreign investment in shipping related business including shipping agency and ocean freight forwarding services are being gradually removed.

- **Privatization of public sector shipping lines**

Move towards increasing private sector participation in the government owned and operated shipping lines. Proposals considered vary from sale of shipping line to national or overseas operators to the formation of joint ventures or consortiums.

Although governments are willing to accept the poor performance of public sector shipping companies and the need to infuse capital and management expertise, governments still have reservations when considering the formation of new public/private sector partnerships.

Abolishing of cargo reservation schemes

Cargo reservation schemes that were originally introduced to promote the national shipping lines have been drastically reduced or abolished. A few countries that still practice cargo reservation schemes are in the process of undertaking a serious review.

Flexibility of crew nationality requirements

The employment of foreign crews are being increasingly allowed. This is also taking place in developing countries which have a scarcity of qualified national seafarers.

- **Maritime cabotage**

Countries are reviewing the cabotage systems taking into account the costs involved.

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CHAPTER 3: DETERMINING SHIPPING POLICY OBJECTIVES

Developed maritime countries invest time and resources to formulate comprehensive shipping policies and strategies. Such policies provide guidance to the shipping industry in the development of business strategies and long term plans. Developed country groups such as EU, OECD also endeavour to formulate common policy directions on maritime transport that would reflect their thinking on fundamental issues such as liberalization and competition.

Developing and documenting comprehensive shipping policies is a new endeavour to the majority of countries in the ESCAP region. Apart from specific policies and agreements adopted by members of ASEAN, no common positions have been developed on maritime transport by countries in the ESCAP region. In order for common position to evolve, it is necessary that developing countries in the ESCAP region determine their own policy positions on a range of shipping issues and reflect upon the prospect of strengthening and harmonizing their policy directions on key issues.

Scope and extent of policies to be developed

The term “shipping policy” can be interpreted in a wide sense to cover the entire maritime sector or in a narrow sense to cover trade and service related shipping policies. Even if the term is narrowly defined, shipping policies cannot be developed in isolation. Shipping policies have to also take into account policies being developed in ports, infrastructure and ancillary services, road and rail transport and related industry sectors. It is therefore important that the government decides at the outset, the scope of the policies to be formulated from the range of topics that would be covered in a comprehensive maritime policy.

Table 3.1: - Topics covered in a comprehensive maritime policy

Port infra-structure	Ancillary Maritime Services	Competitive Shipping Services for Trade	Development of national shipping capabilities	Safety of life and protection of marine environment	Human Resource Development
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At the outset of this project, ESCAP undertook a survey of the shipping policies of the countries in the region. Participating countries were asked to identify the broad shipping policy objectives. Although the overall objectives

differed from country to country, they were directed at maximizing the varied maritime potential of each country.

The following table (Table 3.2) is a brief summary of the position of some of the participating countries.

Table 3.2: Broad shipping policy of selected countries in the ESCAP region

Country	Broad objectives of countries' shipping policy
Australia	Enable access to more competitive and reliable shipping and waterfront services, for Australia's tradeable goods and greater transparency, in the service delivery cost of ports and shore based cargo handling industries.
Bangladesh	To make sustainable development in the maritime sector in order to improve the socio-economic condition of the country and to ensure maritime safety and protection of maritime environment.
Indonesia	Access to more competitive and reliable shipping and waterfront services, greater transparency in costs, create economic, safe and reliable shipping services.
Iran	Providing competitive shipping services which are safe, reliable and efficient to meet the needs of the country and shipping.
Myanmar	To provide adequate shipping services to cater for foreign trade with emphasis on infrastructure development and maintaining a high level of safety.
New Zealand	To promote safe, efficient and environmentally sensitive shipping and promote and safeguard reliable competitive shipping services to the benefit of the economy.
Pakistan	To develop merchant shipping capable of providing effective and economical maritime and multimodal transport services to seaborne trade at optimum level. Provide job opportunities to seafarers, save foreign exchange and improve balance of payments, facilitate exports and imports of the country and neighbouring landlocked countries. Expand national fleet to a size which matches a suitable high position among maritime nations.
Singapore	To promote Singapore as a premier port and international maritime centre and to safeguard the strategic maritime interest.
Thailand	To promote maritime business and related industries.
Turkey	To access more competitive and reliable shipping, promotion of Turkey at an international level and to facilitate access by Turkish shippers to competitive, safe and reliable international shipping services.
Viet Nam	To work out long term strategies; draft laws, ordinances, regulatory policy and rules of management.

Source: Data collected by ESCAP through questionnaires returned by participating governments.

A clearly articulated set of policies would bring certainty and stability to the shipping scene and can motivate the public sector and the private sector to work together to achieve the objectives of the governments. In many instances, however, national shipping policies are not articulated or documented and have to be gathered through preambles to legislative enactments parliamentary debates relating to such legislation, press statements and speeches made by senior government officials.

The following extracts from country papers written by national resource persons give an insight into the shipping policy objectives of selected countries.¹

Philippines:

The broad shipping policy objectives can be gathered from the legislation creating the Maritime Industry Authority (MARINA).

Presidential decree No. 474 declared a policy to accelerate the integrated development of the maritime industry of the Philippines towards the following objectives:

- To increase the production and productivity in the various islands and regions of the archipelago through the provision of sea linkages;
- To provide for the economical, safe, adequate and efficient shipment of raw materials, products commodities and people;
- To enhance the competitive position of Philippines flag vessels in the carriage of foreign trade;
- To strengthen the balance of payments position by minimizing the flow of foreign exchange and increasing dollar earnings; and
- To generate job opportunities.

Malaysia:

Malaysia's shipping policy has focused on two main issues: Fleet expansion and Port development.

The aim of fleet expansion is to reduce dependence on foreign vessels for the carriage of Malaysian cargo and minimizing the economic vulnerability caused by over-dependence on foreign fleets.

Port development aims at making Malaysian ports into transshipment hubs for South East Asia, encouraging local shippers to ship through national ports to save the outflow of foreign exchange and ensure the growth of other maritime related services such as ship building, bunkering, ship handling, banking and insurance.

¹ Extracts from country papers prepared by ESCAP project by national resource persons. Minimum editing by ESCAP secretariat. In the case of Sri Lanka, the information is from the policy document titled "National Shipping and Ports Policy of Sri Lanka (1999) published by the Ministry of Shipping, Ports, Rehabilitation and Reconstruction.

China:

The broad objectives of Chinese shipping policies are:

- To open the Chinese shipping market step by step, encouraging enterprises to compete in the international shipping market;
- To optimize the collation of the water transport resources, establish the fleet that could meet the demands of the development of the Chinese economy, promote Chinese maritime trade, profile the safe, reliable and efficient shipping services for Chinese tradable goods and shippers;
- To strengthen establishment of the law system, form the environment of fair, reasonable and orderly competitive shipping markets of China.

India:

The objectives of Indian shipping since independence have been:

- To safeguard the import of essential supplies, especially POL for the national economy
- To reserve hundred per cent of coastal trade for national flag vessels;
- To ensure adequate provision of shipping services to meet the requirements of national trade;
- To improve the balance of payments position through import substitution and export of shipping services; and
- To develop merchant fleet to act as a second line of defence to protect India's maritime interests and preserve its channels of communication.

Sri Lanka:

The broad shipping policy objectives are spelt out in the national port and shipping policy which envisages Sri Lanka as a competitive shipping centre.

The long-term vision is for Sri Lanka to consolidate and further develop its position as a competitive shipping centre in the South Asian region which would result in the generation of economic activity, employment and income.

The concept of a shipping centre envisages the following:

- Efficient ports that would facilitate the movement of Sri Lanka trade and transshipment trade;
- Exporters and importers having unimplemented access to reliable and competitive shipping services;
- Ancillary services that enhance the position of the Sri Lankan ports in the South Asian region;
- Availability of shipbuilding and ship repair facilities;
- National merchant shipping line(s) that are internationally competitive and capable of assisting the growth of the region's seaborne trade;
- An environment that promotes safety of life at sea and the prevention of marine pollution;
- Trained seafarers who would be up to international standards.

Korea:

The broad policy objectives are to maintain order in maritime transport and pursue sound development of the shipping industry, thus contributing to the development of the national economy and the promotion of public welfare.

In this context, the immediate objective has been to improve international competitiveness of the shipping industry and Korean shipping firms in the international market place.

The corollary objectives are as follows:

- Maintain the balance of supply and demand of shipping fleets by ship type according to the changes in international trade patterns and shipping services;
- Improve ship quality by replacing uneconomical vessels with economic ones;
- Promote ship quality by replacing uneconomic vessels with economic ones;
- Improve the balance of international payments;
- Train the seamen and marine engineers;
- Promote international cooperation.

Governments is pursuing the goal of building Korea as a global shipping centre in the Asia and Pacific region and as a logistics centre in the North East Asia.

Trade and service related shipping policy - regional policy positions

Shipping policies identified by participating countries in the region clearly demonstrate two major policy objectives in the trade and services related shipping sector.

- Maintain a shipping presence through the development of national shipping capabilities.
- Ensure access to competitive shipping services for the countries overseas trade.

CHAPTER 4: DEVELOPMENT OF NATIONAL SHIPPING CAPABILITIES

Countries in the Asia Pacific region are well aware of the importance of competitive, reliable and efficient shipping services for their international trade. Even with easy access to overseas shipping services and a buyers' market, countries in the ESCAP region wish to maintain a shipping presence through the development of national merchant shipping fleets

- *What are the objectives/rationales for such development?*
- *What are the factors that determine the competitiveness of a national fleet?*

Rationales for developing national fleets revisited

In implementing the project on shipping policy, participating countries were asked to revisit the often debated objectives/rationales for the development of national the shipping tonnage. Countries thus prioritized the importance of the following perceived benefits relating to the national fleet(s).

Stable carriage of goods which might not otherwise be carried;
Introduce competitive pressure on shipping services;
Strategic civil or defence support;
Balance of payment benefit;
Development of national industry with employment and other economic benefits;
Encourage the development of shipping related and service industries;
To safeguard the marine environment.

The result presented in Table 4.1 and the deliberations that ESCAP has conducted, clearly indicate that the majority of the countries in this region wish to develop national tonnage and provide international shipping services. This in spite of the fact that these countries are well aware that national shipping lines are finding it increasingly difficult to match the competitive services offered by overseas shipping lines. Table 4.1 indicates the priority attached by countries to the benefits listed by the ESCAP secretariat.

Table 4.1: Prioritization of objectives/rationales by selected countries

Note: 1: Essential; 2: Moderately important; 3: Less important

Objectives	Stable carriage of goods	Introduce competitive pressure on shipping services	Balance of payments benefit	Strategic defence support	National industry with employment & other benefits	Related industry development	Safeguard the marine environment
Country							
Australia	3	1	3	2	2	3	1
Bangladesh	3	3	1	2	1	2	1
China	2	1	2	1	1	1	1
India	1	1	1	2	2	2	1
Indonesia	1	1	1	1	1	1	1
Iran	1	1	2	1	1	1	1
Japan	1	1	3	3	3	3	1
R.O. Korea	1	1	1	1	2	2	2
Malaysia	1	1	1	2	2	1	1
Myanmar	2	2	2	2	2	2	1
New Zealand	1	1	2	2	2	2	1
Pakistan	2	2	1	1	1	1	1
Philippines	2	1	1	2	1	1	2
Viet Nam	3	1	3	1	1	1	1
Singapore	3	1	2	1	2	1	1
Turkey	1	1	1	1	1	1	1

This chapter examines the objectives prioritized by countries in the region, and the rationale behind them, in the light of the current international shipping environment.

Competitive pressure on shipping services

In spite of the difficulties currently faced by national fleets, countries in the region still consider that national fleets could have a positive influence in maintaining competitive pressure on shipping services. If national fleet(s) are to influence freight rates, even in the long-term, then it is important that they remain internationally competitive.

Competitiveness of national fleets

The ESCAP study sought responses from individual countries on their perception of the international competitiveness of their national fleet(s)

Table 4.2: Country perceptions: Competitiveness of the national fleet of selected countries

	operating expenses	A major contribution to the competitive gap	
		Crew costs	Capital costs
Australia	<p>For an Australian owned ship 31% higher than a typical OECD ship</p> <p>35% higher than a typical open register ship (FOC)</p> <p>For a bareboat chartered ship 14% higher than a typical OECD ship 16% higher than a typical open register ship (FOC)</p>	100% higher than a typical OECD ship 139% higher than a typical open register ship (FOC)	23% higher than a typical OECD/FOC ship
Bangladesh	lower	lower	lower
China	Generally perceived as being more expensive	Crew complement on board is 35 personnel as against ship with 18 in the developed countries	Ageing fleet; over 23 years old
India	Generally perceived as being more expensive	12-15% higher than a FOC ship Crew complement with 47 personnel High age profile of crew	At market rate for ship finance due to absence of ship financing schemes
Indonesia	125-140% lower than international competitors	lower	lower
Iran	150% lower than international competitors	lower	similar
Japan	2-3 times higher than international competitors - uncompetitive situation	<p>(US\$ million)</p> <p>Full national crew 2.34 FOC 1.56 Full Asian crew 0.56 150% higher than a FOC ship 390% higher than a ship with full Asian crew</p>	similar

Republic of Korea	Lower than a typical FOC ship	Panamax 50,000 dwt. ship with 21 crew of which 6 foreign crew are on board (US\$ 1,000) FOC Korean crew: 793 Chinese crew: 360 Filippino crew: 550	Higher than international competitors because financing cost in the "LIBOR+Spread" were drastically increased
Malaysia	similar	lower	similar
Myanmar	same	lower	similar
New Zealand	150% higher than international competitors	higher	higher
Pakistan	15% lower than international competitors	lower	lower
Philippines	very competitive	very competitive	Competitive through bare boat charter with hire purchase option
Viet Nam	much lower	lower	lower
Thailand	lower	lower	lower
Singapore	lower	lower	lower

Source: Table prepared by ESCAP on the basis of responses to questionnaires by government departments/ministries from selected countries in the region.

The competitiveness of the national fleet can, to some extent, be gauged by the share of the seaborne trade of the country carried by the national fleet (It is recognized that capacity could be a constraining factor. Investment in increased capacity would be anticipated if market conditions indicated strong viability). Data obtained from selected developing countries in the region indicate that overseas vessels carry more than three quarters of the countries external trade.

Table 4.3: Performance of national fleet in carrying the seaborne trade of the country - selected developing countries

Country	Share of cargo carried by national fleet
India	30.0%
Malaysia	22.0%
Philippines	10.0%
Thailand	12.0%

Source: Information from country papers prepared for ESCAP.
Malaysia based on container throughput at Port Klang alone for 1996

In countries where trade volumes have increased and yet the tonnage share of seaborne trade carried by the national fleet declines, the competitiveness of the national fleet(s) would have to be questioned. An example of this would be the national fleet of Japan whose share of the import trade has decreased in each of the last nine years. It is evident that the Japanese fleet, like that of many industrialized countries is becoming less competitive due to high operational costs, and this has resulted in flagging out.

Table 4.4: Performance of national fleets in carrying seaborne trade of country - developed maritime countries

		1987	1988	1989	1990	1991	1992	1993	1994	1995
Japan	Export	34.7%	38.2%	38.4%	39.9%	39.7%	40.2%	38.0%	38.9%	36.7%
	Import	38.5%	35.4%	32.7%	28.6%	27.5%	26.9%	26.0%	23.2%	20.2%
USA	Total	4.0%	3.9%	4.4%	4.1%	4.1%	3.9%	4.2%	3.9%	3.3%
	Liner	14.9%	16.8%	19.1%	17.4%	16.7%	16.2%	15.5%	14.1%	11.7%
	Non-liner	1.9%	1.7%	1.7%	1.8%	2.1%	1.7%	2.5%	2.5%	2.2%
	Tanker	3.4%	3.1%	3.4%	2.8%	2.5%	2.7%	2.6%	2.2%	1.8%

Source: Current situation of Japanese shipping 1997 prepared by MOT and MARAD 1997 Annual Report.

Indian tonnage carries a 30% market share of national cargo but it is yet perceived domestically as uncompetitive. The high tonnage could be due to the reservations applicable to the carriage of oil which is reserved for the national line.

Operating costs of national fleets

The competitiveness of the national fleet can be assessed through an analysis of the cost structure relating to ship operation and financing. Ships are flexible assets which allow innovative management. Every shipowner looks for new ways of increasing the competitive advantage of the fleet. Ships are mobile and most services required by a ship can be obtained in the international market. For example, crew can be readily procured from a country that offers a lower wage rate if the nationality of the crew is not stipulated by the flag of registry.

Ships can be purchased in international markets at the lowest possible cost. This also applies to most of the variable costs of providing shipping services such as bunkering, repairs, insurance and so on. Ship finance is also often raised in the international capital markets.

Today there are only a few purely national cost elements as shown in Table 4.5 below.

Analysis of operating costs

Operating costs are those costs necessary to keep a ship in a condition to carry cargo, and will be almost unchanged whether the ship is actually carrying cargo or not and regardless of whether the ship is sailing or is in port. The operating costs thus dominantly comprise of fixed costs and not the variable costs such as voyage costs.

The main operating costs of a ship are as follows:

- Crew costs;
- Insurance costs;
- Repair and maintenance;
- Stores and supplies;
- Overhead/management costs

Table 4.5: Cost elements for a ship

Cost elements	Market pricing
Taxation	National
Overhead/Management costs	National
Non-equity finance	National/International
Equity finance	National/International
Acquisition of ships	International
Crew manning	International
Maintenance	International
Repairs	International
Insurance	International
Stores and supply	International
Port charges	International
Docking/survey costs	International
Fuel costs (Bunkering)	International

Crew Costs

Crewing costs are considered the dominant component of operating costs. The crewing costs of a ship are determined by several factors, such as the ship type, the trade, the level of automation, employment characteristics, the flag of registration, the nationality of the crew and the relief crew schedule. Every shipowner attempts to achieve the optimum crew complement taking into account statutory requirements, and safety needs.

The crewing costs comprise of wage and overtime payments, social security costs and crew repatriation costs. The crewing costs make a significant contribution to the overall costs of operating a vessel. A reduction of crewing costs is an essential target of the ship operator because it accounts for a substantial portion of operating expenditure. Such reductions are achieved through increased flexibility in crew and manning options. The following discussion examines the way some countries have dealt with the challenge of reducing crew costs in order to remain competitive in the international shipping markets.

Relative cost of indigenous maritime labour

The flag state stipulates the minimum national manning component of the ship's crew. The nationality of the crew is an important factor in determining crew costs. National crew costs in developed countries (OECD countries in particular) reflect the general social and wage conditions of these countries and are much higher than crew costs in developing countries.

Where a national manning requirement is imposed, shipowners would not be in a position to recruit seafarers from a country where the wage scales are competitive. This would particularly affect shipowners from developed countries where crew costs are high. This has resulted in flagging out of ships from the high-cost ship registers to the flag of convenience registers such as Liberia, Panama or Vanuatu which would allow the ship to be crewed by any national. In Japan for example, crewing costs of full national crews on board a national ship is 1.5 times higher than that of a FOC ship.

Reduction in crew size

Shipowners and operators have also directed efforts towards reducing crew costs through the reduction in crew size largely through substantial investments in new and technologically-advanced ships manned by multi-skilled crews. Advanced pioneer ships capable of operating with only 11 crew were developed in Japan and are now in operation.

Table 4.6 below shows the impact of crew cost on competitiveness of Japanese ships with smaller crews. A crew of 11 Japanese nationals is 34% cheaper than a national crew of 16, but still more than three times as expensive as a crew drawn from other Asian countries.

Tablet 4.6: Comparative crew costs for advanced pioneer ship operated by Japanese shipowners

Crew Type	Annual cost (US\$ millions)
Full national crew of 16	2.9
Full national crew of 11	2.1
National crew of 29/mixed crew of 14	1.9
All crew from other Asian countries	0.6

Source: Japan Shipowners' Association

With regard to the competitiveness of the Korean fleet, a Panamax vessel with 21 crew members (including six foreign crew members) would have a crew cost which is 1.4 to 2.2 times higher than a FOC ship with Chinese and Filipino crews respectively.

Introduction of second or international registers

Some governments in advanced maritime countries have introduced a second or international register as a means of stemming losses from the national fleet. Second registers generally has most of the characteristics of an open register, i.e. increased crew flexibility and access to a more beneficial taxation regimes, compared with ships within the national register. The largest second registers are the Norwegian International Ship Registry (NIS) and the Danish International Ship Registry (DIS). [This issue is examined in detail in Chapter 6].

Crew costs and international wage rates

It is clear that shipowners are able to reduce crew costs dramatically through the employment of low wage crews, many of whom have a high level of competency. In cases where low wage crews from developing countries are employed, it is important that shipowners pay wages that are in accordance with internationally accepted wage scales. The minimum standard for wages and conditions are those set by the ILO and those recognized by the International Transport Workers Federation (ITF).

In some European countries, shipowners are given the right to withhold a certain percentage of personal income tax and social security payment of seafarers as an incentive to hire European seafarers by offsetting part of the high wage level in their country.

Some governments reimburse a certain percentage of economy class airfare to the shipowners as a subsidy towards high crew costs when they allow the seafarers to return to their home country.

Shipowners in the ASEAN region have also recently introduced mixed crew manning on board their national fleets.

In Thailand, Thai law presently requires that 51% of a ship crew must be Thai nationals rather than the 75% required previously, but the country's shipowners are finding it very hard to comply with this requirement. The other 49% of the crew on Thai ships are invariably made up of crew from Myanmar, Cambodia, Viet Nam and China.

Malaysia, which faces a shortage of seafarers, depends on foreign crews largely from the Philippines, Indonesia, Myanmar and Bangladesh to man nearly 60% of the national fleet.

Some countries provide exemption of personal income tax for crew on board a national ship in order to make the overall wage package attractive to the crew and thus allowing the shipowner to set the wage scale accordingly. This concession also makes it attractive for seafarers from developing countries in the region to work on national flag vessels.

Table 4.7 lists the income tax relief afforded to crew by selected countries.

Table 4.7: Income tax relief to make crew wages attractive

Country	Personal income tax	Crew relief	Others
Australia (1)			
Denmark (2)	Exempt for seafarers on board DIS registered ships	Yes	
France	Reimbursement of "tax professionnelle" partly based on gros salaries		Tax concession 50% on social security
Germany (2)	The right of shipowners to withhold 40% of seafarers income tax		
India	Special tax concession If more than 184 days spent overseas		
Indonesia	Special tax concession		
Republic of Korea	Exempt up to monthly income of Korean Won 1 million		Special tax concession on social security
Philippines	Exempt		
Netherlands	The right of shipowners to withhold 30% of seafarers income tax	Yes	Reimbursement of social security payment of seafarers income tax
New Zealand	None	None	None
Japan	None	None	None
Malaysia	Exempt		
Norway (2)	30% deductible with an upper limit of 70,000 Krone	Yes	
Singapore	Exempt		
Thailand	Exempt		
UK	Exempt if more than 183 days spent overseas	Yes	Special tax concession on social security
Viet Nam	Special tax concession		Special tax concession on social security

Source: Table prepared by ESCAP from responses to questionnaires from selected countries and country reports.

- (1) Australia is considering exempting seafarers on Australian ships engaged on international trade from income tax with the introduction of the Australian Second Register.
- (2) These 3 countries introduced the second register that is named as NIS for Norway, DIS Denmark and ISR Germany respectively.

Insurance

The shipowner normally insures physical damage or loss to ship and liability to third parties. The Hull and Machinery Insurance (H&M) insurance is primarily a cover of the shipowner's property interests against loss and damage. There are several insurance markets through which H&M insurance can be obtained, the best known market being Lloyds of London.

Liability to third parties, for example damage to the goods and damage caused by the ship including injury and loss of life can be covered through a Protection and Indemnity insurance (P&I Insurance). The P&I insurance is obtained through mutual protection societies, (P&I Clubs), of which shipowners are members.

Insurance premiums have been on the increase recently, but would vary between shipping companies. Premiums depend on several factors including the value of the vessel, the owner, operator, age, specifications, trading area and the claims record.

Repair and maintenance

Repair and maintenance costs cover the ordinary maintenance needed for a ship to operate efficiently and "remain in class". Although there is no legal requirement for a vessel to be entered with a classification society, certification from a classification society becomes necessary for the operation of the ship particularly in calling at overseas ports and in obtaining insurance. Such certification indicates the seaworthiness of the vessel. There are a large number of classification societies in operation today, a few of which belongs to the International Association of Classification Societies (IACS). The Lloyds Register (LR), the American Bureau of Shipping (AB), the Nippon Kaiji Kyokai (NK) are among the leading societies.

Ships have to undergo routine surveys to stay in class. These include dry docking and special surveys at regular intervals. The reduction in crew numbers and the limited time spent in port has resulted in the inability of the ships crew to undertake routine maintenance on board. This in turn has resulted in an increase in maintenance costs which have to be outsourced.

Stores and supplies

Food and other provisions required by the crew as well as stores and supplies necessary to maintain the ship such as paints, cleaning materials, fresh water and spare parts referred to as victualing is another operational cost.

Overhead and management costs

Overhead and management costs depend on the size of the shipping company and the number of ships that are managed as well as efficiency.

Capital costs

Capital costs, together with the operational costs will add up to the daily operational costs (DOC) or ship standing costs. The capital costs for a ship or a shipping company is the sum of the depreciation of the assets, interest payments, and return on owners investment (cash or equity). The capital costs would also depend on the nature of the vessel (new or second hand), the amount of borrowing and the economic life of the ship.

Two aspects of capital costs, depreciation and roll over relief which would have an impact on the competitiveness of the national fleet are considered in this section, while interest on capital is discussed in Chapter 9.

Depreciation

Depreciation measures the consumption of capital which occurs in the process of producing the service. Such losses of asset value, especially ships, may be caused through wear and tear or through obsolescence or simply through the aging of the vessels. The shipowner should be in a position to redeem the acquisition cost of a ship so that he can replace his ships when required and, thereby, remain competitive.

There are several methods for calculating the depreciation of ships. Typical depreciation methods are straight line method and “reducing balance method”. Both these methods start from 100% of purchase cost.

In countries such as Denmark and Germany, however, the standard depreciation allowance may start from a lower cost because of preliminary/advance depreciation allowance. The depreciation rate may range from 20% to 35% on a reduced balance method.

Table 4.8: Depreciation allowances in selected countries

Australia	economic life of vessel
Bangladesh	choice of RB or straight line method
Denmark	30% RB on 100% of cost less any preliminary depreciation
France	choice of RB or straight line method
Germany	25% RB on 100% of cost less any advance depreciation
India	5% straight line method
Japan	straight line method or 14.2-20.6% RB on 100% cost
Republic of Korea	7.6-14.2% straight line method or 20.6-34.9% RB on 100% cost
Myanmar	straight line method
Norway	20% RB on 100% of cost
Singapore	33.3% straight line method
UK	25% RB on 100% of cost

Note: RB stands for Reducing Balance

Source: Country reports and questionnaires and OECD Maritime Transport Committee's 1996 inventory of support measures and arrangements provided to international shipping and material.

In addition to normal depreciation method, some countries have additional depreciation regimes as shown in Table 4.9.

Preliminary depreciation

Denmark is the country that is most supportive of this type of depreciation. It allows "preliminary depreciation" to be extended for a new vessel between the time of ordering and entry into service. This can be as much as 30% of the contract price, but the yearly maximum depreciation is 15%. To be entitled to apply this method of depreciation, the minimum building cost has to be at least D.Kr. 200,000.

Table 4.9: Additional depreciation methods

Denmark	Preliminary depreciation up to 30% of costs but not exceed 15% per annum
Germany	Advance depreciation up to 40% of costs in first year
Japan	Special depreciation of 18% of costs in first year
Malaysia	Accelerated depreciation 20% in first year + a special allowance of 6-10%

Source: Based on MARIT.POL.MGMT., 1997, Vol.24, No. 3
OECD Maritime Transport committee's 1996 inventory of support measures and arrangements provided to international shipping and material available and the Malaysian country report.

Special depreciation

The special depreciation scheme extends tax deferral to shipowners for a certain period. Within this system a certain percentage of original acquisition cost of a new ship are allowed to be retained as non-taxable income during the first year when acquisition of a new ship is made under certain conditions.

Such retained earning would be deducted equally every year over a certain period as taxable income.

In Japan, this method of special depreciation is applied to newly built sea going ships with a capacity of 3,000 grt. or more equipped with modern navigational systems. When in conformity with these requirements, 18% of the original building cost may be allowed under an expiration date of 31 March 1999. The retained earnings in the first fiscal year of use are deducted equally, i.e. one-seventh every year, over the period of 7 years allowed under the tax regulation. The amount corresponding to the one-seventh deducted every year out of the retained earnings becomes taxable income.

In Germany, the system was applied to vessels owned by its nationals and registered under the German flag within the first 5 years after deployment but the scheme was abolished in 1998.

The United Kingdom reduced its support measures for shipping in the 1980s, abolishing special depreciation in particular, with the result that, as conditions in the shipping industry worsened, British owners flagged out or withdrew from the industry altogether.

Rollover relief on proceeds from disposal

“Rollover relief” provides the right to reserve profits made on the sale of ships for a number of years on a tax free basis provided these profits are reinvested in ships. The relief was established to reduce liabilities and enhance the ability of the industry to modernize the fleet, although the cycle of replacement of a vessel differs from shipowner to shipowner.

Table 4.10: Rollover relief regimes in Selected Countries

Country	Tax deferral allowable
Australia	current year
Denmark	2 years
France	4 years
Germany	4 years (50%)
Japan	1 year (80%)
Netherlands	4 years
Norway	8 years
Singapore	current year
Thailand	1 year
UK	6 years

Proceeds from the sale of a vessel registered under second or international register are often exempt from tax if used to purchase a replacement vessel within a certain period of time.

The rollover relief regime in various countries as described in Table 3.9 affords the shipowner the opportunity of deferring taxes and reinvesting surpluses tax-free to update the national fleet. The regimes range from one year to eight years.

The Indian special reduction allowance is similar to a rollover relief. Indian shipping companies can set aside 50% of the profits before taxation in a special reserve provided this is utilized only for acquisition and the special reserve should not exceed the total paid up capital of the company.

In the United States of America, there are two programmes, the Capital Construction Fund (CCF) and the Construction Reserve Funds (CRF) which can be utilized to construct qualified vessels.

The CCF Programme is a method of assisting United States of America operators to accumulate the capital necessary for the construction, reconstruction, and acquisition of vessels constructed in United States of America shipyards to be entered in the United States of America registry. The CFR programme provides many deferral benefits to the United States of America shipowners.

Corporate income tax

The residual income remaining after corporate income tax has been paid, is a matter of importance to shipowners and potential shipowners. Corporate taxes are normally charged as a fixed percentage of the company's taxable income. The percentage of tax varies from country to country but it is difficult to assess whether the taxation in a country is high or low as the available allowances have a significant influence on the taxable income and thus the final tax payable.

The tax regime applicable to the shipping industry in selected countries is illustrated in Table 4.11.

Income tax regimes in ASEAN countries

Singapore and Malaysia - tax exemption for corporate income, in order to promote the development of the national merchant fleet.

Thailand - Up to 1977, shipowners in Thailand were disadvantaged as against neighbouring countries due to their having to pay corporate tax at 30%. In 1997, Thailand followed Malaysia and Singapore and exempted shipowners from corporate income tax.

Taxation and foreign owners

Some countries have also introduced measures to attract foreign shipowners to their national registers by providing a tax holiday on corporate income tax under special conditions. Singapore offers a tax holiday if at least 10% of a shipping companies fleet is flagged under the Approved International Enterprise Scheme.

Internationally competitive taxation systems encourage shipowners to operate under the national flags and provide a competitive advantage vis-a-vis ships registered in countries that do not offer such concessions.

Europe

In Europe, a new tax system called a tonnage tax system in accordance with the State Aid guideline by EU has been introduced to replace the normal corporate income tax, which applies to other sectors.

The system allows shipowners to choose their taxable income to be based on a fixed rate per tonnage (mainly net tonnage) of ships concerned. This is an optional alternative to the normal corporate income tax system, however, there are many obligations attached to choosing the system.

Stable carriage of goods

The transport of bulk cargo such as crude oil, LNG or petroleum by-products form part of a supply chain where regularity and reliability are critical factors. This is particularly so when they provide an input into tertiary industry establishments, such as power and steel production.

The consequences of the above cargoes not arriving on schedule can be substantial. A high priority is thus placed on the stable carriage of essential goods, either by the development of national shipping capability or through the chartering of foreign flagged vessels. The importance attached to the stable carriage of goods has led to the belief, strongly held by some countries, that transport of essential trade should not be dependent on foreign vessels. The reasoning for this view is summed up as follows:

Overseas shipowners will withdraw from routes or will reduce the number of sailings when low freight rates continue for a long period of time.

Dependence on the charter market makes the trade vulnerable to high freight rates in times of emergency.

The question whether a country should be concerned about its reliance on foreign tonnage to carry its overseas trade has been a subject of much debate.

There are two schools of thought on this matter. One view is that it is in the interest of a country to rely on the international shipping market for its transportation needs provided it is a competitive market which offers a choice of services. The other view is that economic security requires a strong national fleet. This is based on the view that the government can exercise a certain amount of control over the costs and operation of nationally owned ships where as no control can be exercised over chartered vessels.

Balance of payments

Improvement of the balance of payment has been indicated as an important shipping policy objective by countries in the region.

This rationale stems from the following:

In the absence of a national fleet, 100% of the external trade of the country will be carried by foreign flagged vessels.

In the case where the national fleet is very small, a high percentage of the external trade will be carried by foreign flagged vessels.

It follows then that if the country develops national shipping capabilities, measure of external trade can be carried by national flag vessels with a corresponding saving in foreign exchange paid out to overseas vessels. According to this view, a national fleet can help to reduce the external account deficit and would be an overall benefit to the country.

Assuming that the development of the national shipping capabilities have no adverse effect on the competitiveness of the shipping services available to the trade, the positive effects on the balance of payment has been analyzed in a recent study as follows. (e.g. Thai flag vessels)

Net foreign exchange earning



Total freight earnings

Less

Costs incurred by national ships overseas

- | | |
|---|-------------------------------------|
| - | Expenditure at foreign port by crew |
| - | Bunkering costs at foreign ports |
| - | Off shore supplies and victualing |
| - | Repairs if any |
| - | Marine insurance costs |
| - | Agency fees overseas |

Less

Costs incurred by substitute foreign vessel carrying that cargo

- | | |
|---|--|
| - | Bunkers purchased domestically |
| - | Port charges incurred by foreign vessel spending by ships (now on shore) |
| - | off shore supplies, obtained domestically |
| - | Repairs effected domestically |

Less

Capital charges

- | | |
|---|-------------------|
| - | Capital costs |
| - | Interest payments |

Plus or minus

Seafarers remittances from nationals employed on overseas substitute ship

The study concluded that in order to assess the real impact of the balance of payment on the external account, one has to ask the following question “what is the effect of replacing a foreign vessel engaged on Thai trade with a Thai flag vessel”.

The study also concludes that the long term benefits of sustaining uncompetitive industries must be weighed against any immediate positive effect on the balance of payment.

Countries that place a high priority on policy objective of improving the balance of payment should also bear in mind the following:

Outflows of foreign exchange associated with freight payments to overseas vessels are to some extent offset by inflows from expenses incurred by a overseas vessel while in the local port.

The low return on investment in shipping as against other industries and the effect on the balance of payment.

Strategic defence support

The potential utility of the fleet for military or civil defence purposes will be directly related to the availability and suitability of the fleet for the military purposes.. The strategic value of the national fleet for defence purposes is indicated by most countries as of moderate importance.

The United States of America on the other hand has set strategic defence support as a key objective of its shipping policy. As explained in Chapter 2, Operating Differential Subsidy (ODS) is granted to United States operators who agree to equip their vessels with defence-related features and make the vessels available in times of national emergencies.

The usefulness of a merchant vessel designed to carry cargo for defence purposes is a debatable question. It is, however, important to note that in time of war or strife, when overseas vessels are reluctant to engage in servicing the trade, national merchant vessels could be used to ensure “business as usual”.

Employment generation

Generation of employment is an important economic objective of every country. The shipping industry gives rise to two types of employment - seafarers and shore based personnel. The generation of employment in the seafaring sector

is identified as a shipping policy objective in some countries in the ESCAP region. These policy objectives are two-fold:

- increase employment opportunities on national fleet
- increase employment opportunities on overseas ships

The existence of a national fleet(s) gives rise to employment opportunities. It also enables the training of seafarers who could then find employment on overseas vessels.

Seafarers, particularly senior deck and engineering officers often move on to employment in the shore based maritime sector and provide essential expertise in a range of jobs with shipping lines, ports, ship repair yards and the maritime administration.

It is a commonly held belief that the reduction or elimination of the national fleet will result in job loss amongst ship crews. This is correct. However, the extent of any net job loss in the economy will depend on the extent of economic gain that would be made in other sectors where funds that could have gone into the purchase of ships are invested.

The elimination of the national fleet should not prevent seafarers of countries in this region from finding employment with overseas vessels. One of the problems that these seafarers will have to overcome however would be appropriate training and training slots on overseas vessels to obtain the required sea time.

Countries in the region that want to tap into the growing market for seafarers must ensure the appropriate training of their seafarers and ensure that the training meets the requirements of the IMO Standard of Training, Certification and included Watch keeping (STCW95) and that the country is included in the IMO white list.

Some developing countries in the region, notably the Philippines play a vital role in supplying national crew to developed maritime countries and earn valuable foreign exchange. Out of a total of 419, 413 registered Philippines seafarers in 1996, 175, 469 were employed on overseas vessels according to statistics from the Philippines Overseas Employment Administration (POEA).

Development of maritime related industries

Countries in the region have placed varying importance on the development of maritime related industries. Maritime related industries which generate economic activity and employment usually centres around the national merchant-vessels or the ports.

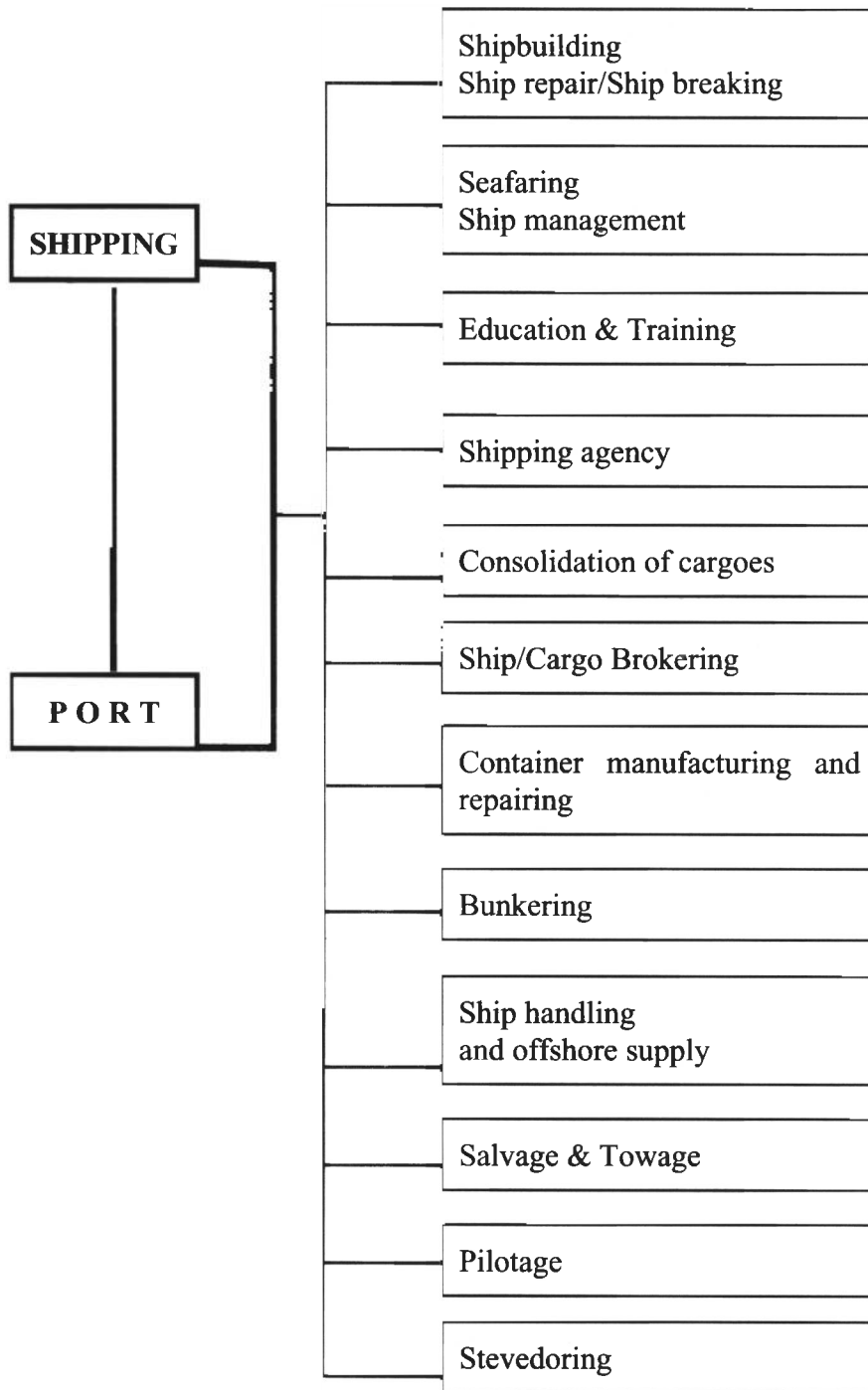
The modern structure of the shipping industry now in place in many of the developing countries in this region developed around the nucleus of the national fleets. Acquisition of ships led to the establishment of the shipping register, the development of ship repair and handling services and other expertise necessary to manage and operate shipping vessels. The development of the national shipping fleet(s) have also resulted in the establishment of appropriate institutional and legal regimes. These countries thus set about establishing the commercial, institutional and legal infrastructure necessary to operate the fleet.

The ports are the other major industry which can grow out of the expansion of trade and shipping services (both national and overseas). Ports in turn also help in the development of the hinterland and generates further economic activity and employment. The last decade has also seen the emergence of hub ports catering to transshipment cargo. Countries in the region that are strategically located have thus developed into major hub ports, (Singapore and Hong Kong) and secondary hub ports (Colombo, Dubai, Port Klang).

A major hub port requires all the ancillary maritime facilities in order to be attractive to main line and feeder operators. At the same time a hub port becomes the nucleus around which maritime related activity can grow.

The development of a national merchant fleet and port facilities will thus have a spin off on the development of other industries.

Table 4.12: Maritime related industries



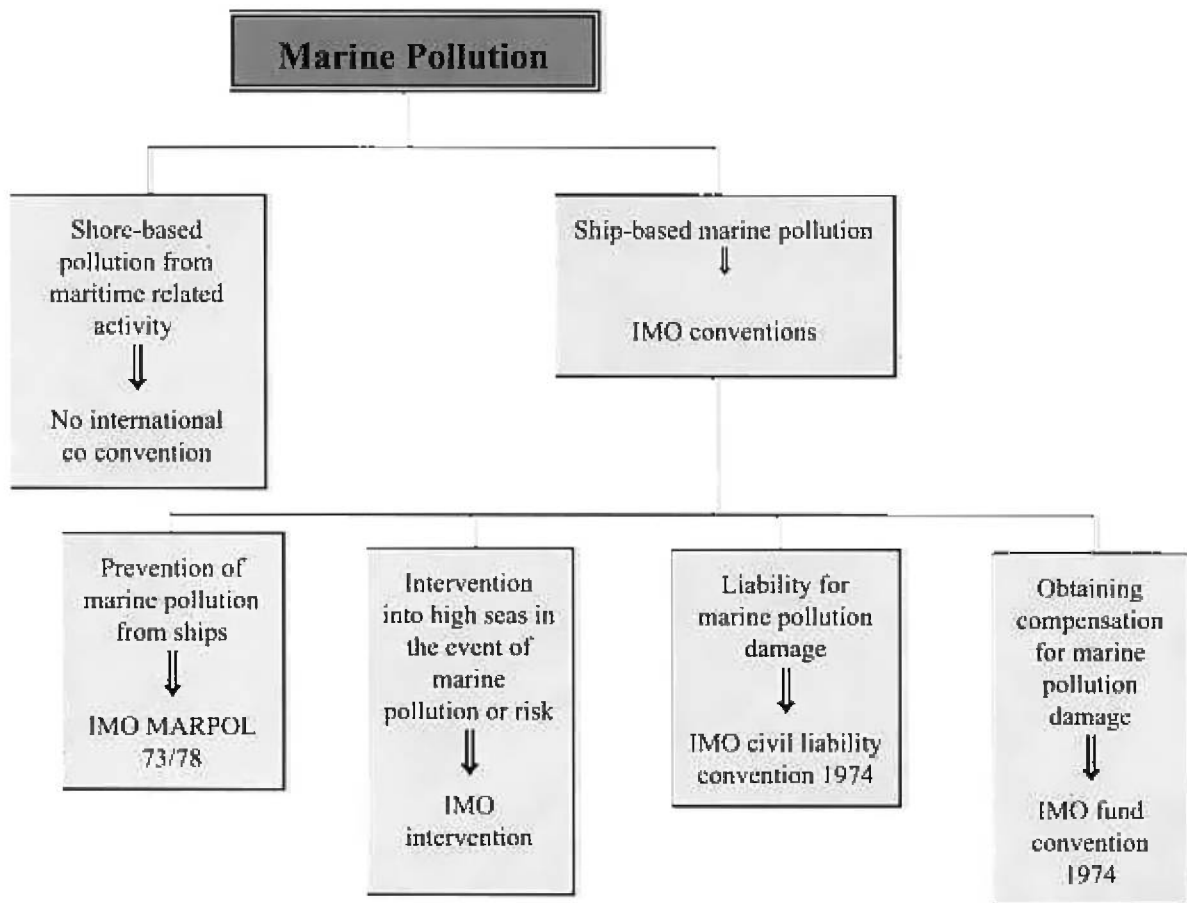
Safeguard of the marine environment

Every country in the region has placed the highest priority on the protection of the marine environment, as one of the rationales for the development of a national fleet.

Pollution of the sea can be from shore based maritime related activity or from ship based activity. Unlike shore based pollution, the prevention of marine pollution and compensation for marine pollution damage by ship based pollutants are well covered by multilateral instruments of the International Maritime Organization (IMO). Once a country ratifies these conventions, particularly MARPOL 73/78, and enacts legislation, the provisions of the conventions can be applied to overseas vessels and national fleet vessels which come within the scope of application of the legislation. There appears, however, to be a strong perception amongst policy makers of countries in this region that a national fleet would be more conscious of the need to protect the marine environment than overseas vessels.

Pollution from ship can be operational or accidental and the IMO conventions deals with all these aspects of marine pollution.

Table 4.13: Marine pollution and international conventions



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CHAPTER 5: NATIONAL SHIPPING FLEETS AND ACCESS TO SHIPPING MARKETS

Promotion of a national industry at the initial stages of its development can be achieved in many ways. Protectionist measures afforded over a long period of time can lead to inefficiencies in operation and service which could be detrimental to the industry that is being protected and to other sectors that rely on the particular industry.

The monopolistic nature of liner conferences in the 1950s and 1960s prompted countries in the ESCAP region to seek unilateral, bilateral and multilateral measures to access the foreign trade of the country. The gradual lifting of these measures from an early time would have helped the national fleet(s) to learn to become competitive in a liberalized environment over a period of time.

Promotion of national fleet(s)

National shipping fleets that are internationally competitive would contribute to the long-term stability and efficiency of shipping services and help promote trade and generate economic activity.

National shipping fleet(s) that are not internationally competitive and cannot match the freight rates or service levels of overseas shipping lines will not be able to survive in a free market unless:

they are subsidized by governments to such an extent that they could offer freight rates below cost; or

preferential treatment is provided through cargo reservation and other similar schemes.

Both measures would have short-term and long-term cost implications for the country, and would have to be considered carefully and policy positions determined before the next round of WTO negotiations on maritime services.

Protectionist measures may relate to favourable access to the international trade or its coastal trade by the national fleet(s).

Protectionist and other support measures: International trade

During the 1970s and early 1980s many developing countries adopted protectionist measures in the form of cargo preference policies and other measures to develop their national fleets with liner shipping conferences. As explained in Chapter 2, policies towards liberalization gathered strength in the 1980s. It brought with it national and international pressure on developing countries to move away from such protectionist measures as in most cases they were causing inefficiencies in the market, in particular, at the expense of exporters. In addition, globalization of markets accelerated by the establishment of WTO and requirements to further open up markets access and abolish barriers in trade are profoundly affecting the shipping policy trends of countries in the ESCAP region. This does not mean that strategies aimed at protecting the national fleet have disappeared from the shipping scene.

Table 5.1 contains a summary of the current scenario on shipping market access in countries in the ESCAP region. It is clear from the table that some countries still support the national fleet participation in the countries trade through enforcement of multilateral and bilateral instruments, administrative directives, and commercial arrangements.

Bilateral, cargo sharing agreements

Bilateral agreements are entered into between two countries and could deal with a range of topics including trade and transport. Some bilateral agreements contain specific policies reserving the carriage of foreign trade generated between the two countries to national tonnage.

Bilateral trade agreements were common in trade relations between countries with centrally planned economies and trade between centrally planned economies and market economy countries. The People's Republic of China has concluded bilateral agreements with 51 countries including the United States, but only six agreements contain cargo sharing provisions. The bilateral agreement between China and the United States of America provide for parity in bilateral liner cargo, to (both export and import commercial cargo), with the rights to carry at least one-third of such cargo being given to national tonnage.

**Table 5.1: Current situation on market access by the selected countries
in the ESCAP region**

	Bilateral cargo reservation arrangements	Preferential policies for national lines	Differential pricing regimes against foreign vessels
Australia	None	None	None
Bangladesh	YES (Right to carry 50%)	UNCTAD Code of Conduct for Liner Conferences	None
China	YES	None	None
Hongkong, China	None	None	None
India	YES	- UNCTAD Code of Conduct for Liner Conferences - Cargo preference for the national flag carrier for shipment of crude oil on FOB basis only	None
Indonesia	None	Cargo reservation for government cargoes	YES (Details unknown)
Iran	None	None	YES (Details unknown)
Japan	None	None	None
Republic of Korea	None	None (All cargo reservation schemes abolished by end 1998)	None
Malaysia	None	None	None
Myanmar	None	-Imports by state owned agencies are purchased on FOB basis. -Cargo reservation for the national flag carriers.	None
New Zealand	None	None	None
Pakistan	None	First right of refusal for steel imports and government project cargoes	None
Philippines	YES	None	None
Viet Nam	None	40-40-20 cargo sharing formula	Two tier pricing on port charges between overseas and national ship

Source: prepared by ESCAP based on questionnaire responses collected.

Bilateral cargo sharing agreements are in the process of being phased out. This is partly due to centrally planned economies moving towards market oriented economies. International policy trends, are also a deterring countries from entering into such bilateral agreements. For example, bilateral agreements reached between the People's Republic of China and Thailand do not contain any cargo sharing agreements. Cargo sharing agreements between countries are also increasingly difficult to implement as policies of liberalization provide importers and exporters with the freedom to choose the carrier.

Bilateral agreements which may give least developed countries the right to make cargo reservations do not have a practical impact on international carriage as these countries do not have the tonnage required to carry the trade generated.

The United Nations Code of Conduct for Liner Conferences

The UN liner code was developed by UNCTAD at the request of the international shipping community in the early 1970s at a time when there was growing consensus among the shipping community, particularly the developing countries that a code of practice was required for the liner conferences.

The following provides an overview of the development and workings of liner conferences:

1909 - The UK government set up a royal commission on shipping rings.

1913 - The US government formed the Alexander Committee and three years later enacted the US Shipping Act. The Act exempted liner conferences from anti trust legislation but imposed a separate set of rules to govern conferences. Shipping conferences operating in and out of the US are open conferences in that any shipping line that can demonstrate an ability to carry cargo has the right to join a conference.

1970 - The UK Rochdale Committee on Shipping examined liner conferences but no action was taken to control them.

1971 - The National Ship Owners of Europe and Japan formulated a code of practice for liner conferences (CENSA CODE) but the code was rejected by developing countries as being inadequate.

It was against this backdrop that UNCTAD undertook the task of formulating a multilateral instrument that would assist developing countries to participate in the carrying of cargo controlled by liner conferences. The liner code was adopted in 1974 . Seventy two countries voted in favour of the code, seven countries voted against it and five countries abstained.

The code incorporated the following principles:

The right of countries to become members of the liner shipping conferences that serve the external trade of their country.

The right of participation by sharing the carriage of such cargo on an equal basis with the shipping lines of the trading partners.¹

Equal treatment as full members of liner conferences in the decision making process of the conferences.

The right of shipper organizations to full consultation with conference members on all matters of common interest and the rights of government to participate in such consultations.

A set of criteria for freight rate determination including currency and port surcharges and a procedure for general freight rate increases and surcharges.

A set of principles and a mechanism for the settlement of international disputes arising from the implementation of the code.

The UN Liner Code was adopted at a time when liner conferences dominated the major shipping routes and operated without a common framework. When the code came into force in April 1983 the environment had changed. Conferences no longer enjoyed an absolute monopolistic situation and the non conference lines had begun to establish their presence.

Article 2 of the UN liner code:

(a) The group of national shipping lines of the two countries the foreign trade of which is carried by the conferences shall have equal rights to participate in the freight and volume of traffic generated by their mutual foreign trade and carried by the conference.

(b) Third country shipping lines if any, shall have the right to acquire a significant part, such as 20 per cent, in the freight and volume of traffic generated by that trade.

Nevertheless, the conference to review the liner code convened 1 May 1988 pursuant to article 52 of the liner code and continued at a resumed session in May and June 1991, unanimously recognized the validity of the convention for its 75 contracting states as an international legal instrument for the regulation of liner conference shipping, taking into account the special needs and problems of the developing countries.

The intervening years since the last review conference has seen further structural change in the liner shipping market that precludes the implementation of the UN convention. These changes relate to the fact that:

Containerization has paved the way for the participation of large and aggressive independent carriers in the liner shipping markets. These carriers have captured a large share of the trade on major ocean routes.

Developing countries for whom the convention was designed, have found difficulty in providing competitive liner shipping services even on routes where conference lines enjoy a reasonable share of cargo. Apart from a few countries, which include the People's Republic of China, Singapore and the Republic of Korea and to some extent Malaysia, the large capital, managerial and technological expertise required have put participation in container shipping services on the major routes beyond the reach of developing country shipping lines.

The increasingly intense international competition has further aggravated the problems faced by developing countries shipping line.

The ESCAP survey findings indicate that some developing countries continue to apply cargo reservation measures in the liner trade, justifying these measures on the basis of the Liner Code.

Cargo preferences and government procured cargoes

In some countries preference is given to the national fleet for carriage of government procured cargoes. Typically the national fleet will have the first right of refusal and only then will foreign flagged ships be allowed to participate in the carriage of such cargoes under a waiver is granted to foreign flag ships registered with the maritime administration of the country concerned.

Government procured cargoes, normally comprise of the following:

Military equipment and parts.

Project cargoes financed by the government.

Cargoes generated through government loan arrangements.

Cargo generated by state owned companies and corporations - (state trading corporations).

Relief/aid cargoes.

Country positions

Developed maritime countries

The U.S. economy benefits from the carriage of its goods to and from the U.S. in foreign vessels, at lower cost than would be possible in U.S. flagged vessels. However, as examined in Chapter 2, the U.S. has reserved government cargoes, such as all of its aid cargoes, project cargoes financed by Export and Import Bank of the United States (EXIM) and export of Alaskan oil, for its own ships.

This is a move that has caused concern amongst the developed maritime countries. The Consultative Shipping Group² (CSG) has expressed its concern over the introduction of a new cargo reservation policy as a move that runs counter to the global trend towards the liberalization of shipping.

The CSG has a mandate to initiate discussions and consultations between members to address specific problems arising from restrictive or discriminatory measures which non-members take and to create a favourable environment for the liberalization of liner shipping markets.

The CSG has a continuing dialogue within the Council of European and Japanese National Shippers' Association (CENSA) and European Shippers' Council (ESC).

Contracting countries of CSG are Belgium, Denmark, Finland, France, Germany, Greece, Italy, Japan, Netherlands, Norway, Portugal, Spain, Sweden, UK and EU.

Newly industrialized countries

In the past Korea has followed a designated cargo preference system for bulk cargoes and a waiver system for liner cargoes which has assisted the growth of its national fleet(s). The cargoes designated for priority shipment by national flag ships with regard to imports, include refrigerated cargoes, coal, iron ore, LNG, grain, crude oil, raw material for fertilizers and petrochemicals, and with regards to exports, cement and steel products. The Korean Government, however, abolished the waiver system in 1995 before its admission into the OECD in 1996. Korea has gradually reduced number of the designated cargoes to three (crude oil, iron ore and LNG) and this too is to be abolished by the end of 1998.

Market access: ESCAP Region

Developing countries in the ESCAP region are aware of the importance of ensuring free access to overseas shipping lines to carry the country's overseas trade. Countries are conscious of the benefit of competitive shipping services to the trade and the need to conform to trends in liberalization of trade in services.

The following extracts from the country papers prepared by national resource persons from India and China convey the policy direction adopted by the respective governments.³

Market Access - India

The Government of India has kept cargo reservation provisions under bilateral cargo arrangements and cargo sharing provisions under the U.N. Code of Conduct for Liner Conferences, outside the market access provisions of WTO. Few bilateral agreements in fact provide for cargo sharing, and presently even these agreements are not enforceable under liberalized trading condition. The absence of centralized cargo allocation machinery guarantees freedom to shippers to make their own shipping arrangements. Similarly exporters/importers are free to utilize shipping lines of their choice in the absence of enabling legislation for the Government of India, to reserve 40% cargo for national bottoms under the U.N. Code of Conduct for Liner Conferences.

Note: Country papers subject to limited editorial changes.

Market Access - China

Cargo reservation measures in China have been two fold. During the time of the planned economy, the Government encouraged shippers to utilize national carriers by way of certain administrative measures. Bilateral maritime agreements with a few countries also contained provisions of cargo sharing arrangements. These two measures were based on what was considered to be international picture, including the 40:40:20 formula in the UN Liner Code.

From the middle of 1980's, reform measures began to take place in the shipping services. In 1984, a decision was made by the state council, requiring reform of the existing administrative mechanism in the field of shipping. The measures focussed on the relaxation of the rigid administrative methods in freight transportation, and the introduction of competition to the shipping sector.

In 1988, another important reform measure was adopted, which completely opened up Chinese freight transport market to the outside world. According to this measure, the Government would no longer assign the share of foreign trade cargoes to carry domestic trade cargoes to any domestic or foreign carriers. Neither would it impose any cargo volumes on the national vessels through administrative measures. Carriers and cargo owners were encouraged to contact directly in respect of the carriage of cargoes based on normal commercial practices. As a result, China phased out all cargo reservation and preference practices.

With regard to bilateral agreements, amongst the 51 bilateral agreements entered into by China, six contain cargo sharing agreements.

It is predictable that the cargo sharing agreements would be gradually phased out in due course, as demonstrated by elimination of the cargo sharing agreement between Thailand and China during the bilateral talks held in 1997.

Cargo preference or preferential treatments are powerful instruments because they put vessels from other countries at a disadvantage, by reducing or completely excluding them from participation in the external trade of the country. While such instruments can assist in the development of the national fleet in the short-term, such policies could have an adverse effect on the nation's economy by increasing the cost of transport and creating an inefficient and inflexible shipping service due to the lack of competition.

The present competitive shipping environment is pressuring even national flag carriers to match market rates quoted by foreign competitors. Shippers who are knowledgeable about prevailing freight rates demand comparative rates from the national flag carriers in order that their goods could be competitive in the world market.

If the national fleet is internationally competitive, market forces would operate to ensure that the fleet enjoys the support of the trade. If the national fleet is not internationally competitive, then, a policy that makes it compulsory for the

trade to ship on national tonnage would have a detrimental effect on the competitiveness of a country's trade. Any economic gains made through the policy of cargo reservation would have to be assessed against these invisible costs.

Developing countries in ESCAP region

In Pakistan, the national flag carrier has first right of refusal on shipments of raw materials for Pakistan national Steel Corporation and Government project cargoes. The state run steel maker, can, however, conclude contracts with overseas carriers if no national flag tonnage is available.

Viet Nam is planning to increase the size of its fleet and maintain cargo reservation policy which, for example, is at the level of 20 per cent of crude oil shipments. There are cargo preference measures applicable to non-military governmental cargoes.

Implementation of cargo reservation or preference schemes

Cargo reservation and preference schemes have been implemented by countries in different ways including:

- (a) A centralized freight booking system that gives the government the right to allocate cargo to national flag tonnage. The scheme can be implemented through legislation or by administrative directives. The freight booking scheme will have to be operated by a separate government entity (e.g. freight booking office or Freight Bureau) or by a government department.
- (b) Terms of trade - countries may adopt a policy that encourages its exporters to sell CIF or C&F and for its importers to buy FOB. This scheme generally transfers the right to designate the carrying vessel to the local seller or buyer. This enables the government to then encourage the trader to allocate the carriage of such cargo to national vessels. The requirement may be enforced through legislation or through administrative direction.

With regard to the terms of trade this policy enables a government to apply the cargo preference schemes to import as well as exports.

State owned agencies in Myanmar and crude oil buyers in India import on FOB basis to facilitate the application of cargo reservation policies.

The terms of trade are a matter for negotiation between the buyer and the seller and would usually depend on the bargaining position of the two parties. The question as to whether a cargo is to be bought or sold on FOB or C&F basis would also depend on who can obtain the most competitive freight rates.

(c) Contract of Affreightment (COA) and long term contracts

A contract of affreightment is basically a long-term agreement to carry a certain amount of non-liner cargo between two ports within a specified time period.

This form of contract is used to safeguard the stable carriage of large quantities of essential cargoes such as ore and coal for the carriage of material destined for the construction of a plant in a distant region.

In Korea, the government has encouraged both shipping companies and shippers who require stable carriage of large quantities of bulk cargoes to make a long-term contract. In this case the freight is normally determined on the basis of the actual cost incurred for the carriage of goods plus a certain level of profit agreed between the cargo owner and the carrier.

A policy of this nature would assist national shipowners to build new vessels without concerns relating to the availability of cargo. Shippers would be assured of new vessels equipped with modern technology to carry their cargo at stable rates over a long period of time. The duration of the contract is usually around 10 years. Shipping lines catering to the LNG trade are usually very reluctant to place new orders for a LNG tanker with ship building cost of more than US\$ 100 million, unless there is an assurance of a long-term contract which is supported by government.

Other measures favourable to national flag ships

Differential pricing regimes can include port charges, pilotage or light dues which discriminate against foreign flag vessels. Viet Nam, for example, adopts a two tier port tariff system which favours the national fleet.

The supply of bunker fuel to national flag vessels at a lower price is another type of preferential treatment. Priority berthing and port handling are also used as effective tools to support national flag vessels.

Protectionist and other support measures: Coastal trade and cabotage

Cabotage is commonly defined as the reservation of the transport task within a country's territory to the surface (land and water) and air transport industries and the labour of that country.

It is the area of water transport with which cabotage is usually associated and indeed the term is derived from the French word *caboter*, meaning to coast and is one of the most widely practiced measures of protectionism in shipping.

Most countries of the world with a coastal shipping trade of any significance have for many years reserved those trades for the national fleet under a cabotage regime. It is only in recent years that the combination of an increasing liberalization of international trade in services and the loss of competitiveness of the fleets of developed countries has seen such reservation policies challenged.

Cabotage policy can be effected in a number of ways and should be regarded as any measure which has the effect of excluding foreign shipping or crews from engaging in a country's coastal trades.

Cabotage regimes

United States of America

One of the clearest examples of cabotage is provided in the USA. The Jones Act and associated legislation require that ships used to carry cargoes and passengers between ports in the USA must be owned by USA citizens, built in USA shipyards and manned by USA crews.

Australia

Australian maritime legislation by comparison does not refer to a ship's flag, its country of build, or the nationality of its crew, when prescribing which shipping may engage in Australia's coastal trades. The only restriction is that any ship wishing to engage in the coasting trade must have a licence issued under the Navigation Act 1912.

In 1996, there were 42 ships in the Australian coastal fleet over 2000 dwt. Four of these ships were registered outside Australia (two with a home port of Douglas, the others from Bergen and St. John's)

Licences are issued subject to the following conditions:

the crew must be paid the Australian wage rates current at the time the ship is engaged in the coastal trades;

the ship must not be in receipt of a subsidy from a foreign government; and

(curiously) where a library is provided for the use of passengers, that the crew must have access to the library in the absence of a separate crew library.

The restriction that Australian wage rates (which are relatively high by international standards) must be paid by any ship operating on the coast can significantly reduce cost benefits associated with the use of foreign shipping. The outcome is a disincentive to engage foreign shipping resulting in another form of cabotage.

New Zealand

New Zealand maritime law by comparison allows foreign ships in transit (i.e. carrying international cargo into New Zealand) to carry coastal cargo. However the time that a foreign ship can spend on the New Zealand coast as an extension of an international voyage is limited by migration laws which impose a 28 day limit on the period that foreign seafarers can work in New Zealand.

European Union

From 1 January 1993 the EU adopted a common cabotage regime, with ships from any Member State recognized by other Member States as national ships. This freedom to provide maritime transport within a Member State applies to EU shipowners who have their ships registered in, and flying the flag of any Member State, provided that the ships comply with all conditions for carrying out cabotage in the Member State. This does not, however, preclude individual Member States from removing or strengthening their own cabotage laws.

The cabotage provisions of the EU are set out in Council Regulation No. 3577/92/EEC of 7 December 1992.

The size and nature of the coastal shipping task in the ESCAP Region

The role that coastal shipping will play in any country's transport chain, and the extent of development of coastal shipping as a industry in its own right, will be dependent on a number of factors including its topography, the nature and location of its natural resources and the state of its economic and infrastructure development. Table 5.1 below shows the size of the coastal shipping task reported by a number of ESCAP countries for the latest year for which they have statistics available.

Table 5.1: ESCAP region, coastal shipping task in selected countries

Country	Coastal Cargo (million tonnes)
Australia	47.8
China	
India	
Indonesia	
Vietnam	2.3

Source: Prepared by ESCAP on the basis of questionnaire responses from selected countries (Latest year for which statistics available, prior to 1998)

Archipelagic nations such as Indonesia, and the Philippines are heavily reliant on coastal shipping to provide essential services to wide spread communities with no effective alternative means of transport. For these nations coastal shipping is essential for carrying passengers as well as cargo. In 1996 there were 40 million passengers carried on Philippines coastal shipping.

While Australia is well endowed with national resources for steel production most of its coal is on its east coast and the iron ore on the west coast, thousands of kilometers away. Coastal shipping is the only cost effective means of bring together large quantities of these commodities at Australian east coast steel mills. Dry bulk cargoes in the form of iron ore, coal and bauxite account for around 60% of Australia's coastal cargoes.

Coastal cargo in India is also oriented towards bulk cargoes. While there used to be significant carriage of general cargo such as food grains, tea and jute in the 1960s these trades are in substantial decline, probably as a result of the development of more efficient land transport services.

The highly industrialized nature of the economy of the Republic of Korea is also reflected in its very substantial coastal shipping task with petroleum accounting for 40% of the trade, iron ore 33% and cement 12%.

A feature of transport in Japanese is that while the coastal shipping task at 549 million tonnes was the second largest in the region, it only represented 8% of the total tonnage of cargo carried by the Japanese domestic transport system. When viewed in tonne-kilometers, however, coastal shipping accounted for 43% of the task implying that most land transport cargo in Japan is only carried short distances.

Cabotage is widely practiced in the countries of the ESCAP region. Table 5.2 below shows countries which have indicated that cabotage regimes are currently in place.

Table 5.2: Restrictions in coasting trades in countries of the ESCAP region

Country	Restriction:		Dispensation for foreign Ships
	Registered ships	Other	
Australia		Yes(1)	Yes
Bangladesh	Yes		Yes
China	Yes		No statistics
India	Yes		Yes
Indonesia	Yes		No Statistics
Iran	Yes		No Statistics
Japan	Yes		Yes
Republic of Korea	Yes		No Statistics
Malaysia	Yes		Yes
Myanmar	Yes		No Statistics
New Zealand	Partly(2)		Yes
Pakistan		Yes (3)	No Statistics

(1) Restricted to ships holding coasting trade licences which must pay wages at the Australian award rate.

(2) Except for international ships operating in transit trades and ships under demise charter to New Zealand operators.

(3) Coasting trades are restricted to licensed ships with national flags receiving licence preference.

Restrictive Regulations

National laws relating to migration, employment, customs and taxation can also impact on the ability of, or attractiveness for, foreign ships or crews to operate on national coasts.

National migration and employment laws often contain clauses restricting the occupations that foreign workers can engage in or the period of time they are allowed to engage in such work, or specify the wage rates that are payable.

Customs laws may regard a foreign ship operating on the coast as an import and liable for duty.

Taxation laws may require the payment of commercial taxation on income or wages derived on the national coast or similarly may bring the ship within the liability of local indirect taxes such as fuel excise.

Any of these areas of law either individually or in combination, can act as an impediment to foreign shipping engaging in coastal trades.

Dispensation from cabotage

It is not unusual for the cabotage regimes of countries to provide for foreign shipping to participate in their coastal trades under specified circumstances. Most commonly this is when specialized types of shipping (e.g. heavy lift) are required, or when ships from the national fleet are either not available or suitable for the coastal task at hand.

The Australian Navigation Act 1912, for example, provides that unlicensed ships may carry coastal cargoes under single or continuing voyage permits when:

no licensed ship is available for the service;

the service as carried out by licensed shipping is inadequate to meet the needs of the relevant port; and

the Minister is satisfied that is desirable in the public interest that unlicensed ships be allowed to engage in that trade.

In 1996/97 there were 571 single voyage permits issued to unlicensed ships which carried over 4 million tonnes of Australian coastal cargo (around 10% of the Australian coastal shipping task).

The cabotage debate

The cabotage debate, i.e. should cabotage be retained or eliminated, is most vigorous in developed countries where the cost of national shipping is high relative to the world fleet and domestic shippers can perceive an economic advantage from access to lower cost shipping services. The debate is particularly vigorous in countries such as the USA and Australia with large coast lines and substantial coastal freight tasks.

The contentiousness of the Jones Act in the USA is such that two lobby groups have been formed to represent the views of retaining and abolishing cabotage, being the Maritime Cabotage Task Force and the Jones Act Reform Coalition respectively. This has resulted in an extensive and well documented public debate which is accessible to the general public on the Internet⁴ Many of the arguments in this debate are equally relevant to other countries with a coastal shipping task.

It is important that countries examining their coastal shipping policies and regulatory arrangements should take into account the full range of factors relevant to their particular coastal shipping task and options available.

Policy makers should bear in mind that the entry of foreign ships to the coast can occur at two levels, through a long term presence on the coast as a dedicated coastal resource, or by cross trading on international voyages. Similarly, the impact of cabotage relaxation will vary across the different shipping trades and each trade will need to be considered for impact. Such trades include:

coastal liner shipping;
dedicated bulk shipping (often shipper owned); and
tramp and general user trades.

The various issues arising in reviewing cabotage are discussed more fully in Annex I.

See Internet sites <<http://www.lexitech.com/jarc/examples.html>> and <<http://www.mctf.com/jonesact.htm>>

Cabotage developments

While there has been substantial debate internationally on the merits of cabotage, most notably in Denmark, New Zealand and the United States, the debate has yet to lead to any significant relaxation of cabotage regimes in countries with a coastal shipping industry of significance. Those few nations which do not have a cabotage regime, such as the United Kingdom and Belgium, do not in general have a coastal shipping task of note.

One country where some liberalization has occurred is New Zealand which has introduced initiatives allowing foreign ships transiting New Zealand to carry cargoes between New Zealand ports. The initiative, however, still leaves much of the New Zealand coastal shipping task reserved for New Zealand registered or operated ships.

The Australian Government, which has a policy platform which includes eliminating cabotage, appointed a Shipping Reform Group in 1996 to examine, amongst other things, options for the removal of cabotage. The Groups report, completed in March 1997, suggested an approach to shipping reform which included increasing exposure of the home fleet to competitive pressures via the wind back of cabotage. The Government has yet to act on the report.

While some countries are considering removing cabotage Canada has gone in the other direction and has reaffirmed cabotage, removing some elements of foreign competition in the process. In late 1992 Canada implemented legislation which formalized existing practices and reserved Canadian coasting trades to Canadian registered or constructed ships. The same legislation revoked preferential rights granted to British Commonwealth ships, which permitted those ships to engage in the coasting trade of Canada.

In Malaysia, the Government has lifted the cabotage policy for Penang and port Klang route whereby foreign shipping lines are allowed to carry cargo between two Malaysian ports as part of its international legislation. The move is designed to allow shipping lines to tranship cargo at local ports.

Apart from Australia and New Zealand, only one other country appears to be reviewing its current coastal shipping policy with a view to possible liberalization. The Philippines, which has been gradually deregulating coastal shipping through the 1990s, is contemplating the relaxation of cabotage restrictions.

Coastal shipping services: India

Till 1960's general cargo, namely food grains, fertilizers, jute, tin, etc. were prominently moved in coastal trade. Such trade has, however, witnessed a gradual decline and has particularly disappeared.

Today the bulk of the coastal traffic comprises of coal (9 million tonnes), clinker, cement, iron ore, crude oil (12 million tonnes) and petroleum products (4.5 million tonnes).

At the end of 1997, the coastal fleet consisted of 112 ships aggregating 554,226 GRT. In addition, there are 121 ships of less than 1,000 GRT.

The slow growth of the coastal trade is attributed to cumbersome customs procedures, high manning scales on ships, lack of infrastructural facilities, competition from road transport with trucks that use heavily subsidized diesel.

Coastal shipping services: China

China has by far the largest coastal trade in the ESCAP region, with 870 million tons of cargo being carried in coastal vessels. By the end of 1997, China had a merchant coastal shipping fleet of 320,000 ships, with a total carrying capacity of 30 million dwt which had been issued transport business licenses to engage in domestic and inland water transport.

A prerequisite for participation in the China coastal trade is a licence of the shipping enterprise and a licence of a ship issued under the regulations of Water Transport Administration of People's Republic of China. Ships of Chinese flag with crew of Chinese nationality may apply for a licence. The ship has to be owned by a Chinese shipping company or a joint venture enterprise.

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CHAPTER 6: SHIP REGISTRATION

Registration, nationality and the right to fly a flag are three interlinked concepts that are essential to the owning and operation of a shipping fleet. Apart from complying with international requirements relating to jurisdiction, the shipping register performs several important functions such as identifying ships that would be eligible for fiscal support and being the depository of mortgage instruments. A shipping register can also be a policy tool that could assist shipping fleet(s) to be internationally competitive. This has led to the development of the open register and the second or international register which competes with the traditional/national register for tonnage.

Concept of ship registration

It would be expected that most countries with a maritime industry, regardless of its size or state of development, would be broadly familiar with the concept of ship registration. This is a concept which has been present since ships have been flying flags at their masts.

Registration confers a “nationality” on a ship and this gives the ship the right to fly the flag of the country in which it is registered. Ship registration is thus a process by which nationality and related rights and duties are conferred on a ship. The country in which the ship is registered also assumes jurisdiction over the ship. Any country that wishes to acquire and develop a national fleet needs to establish a shipping register. All the countries that participated in the ESCAP shipping policy project have national registers at present, but this was not the case when developing countries first acquired tonnage. In some cases the vessels had to be registered under another flag, until the national register was established.

The acquisition and the development of national fleet(s) have thus provided the nucleus for the development of the institutional and legal structure required for modern shipping and the development of maritime related industries.

During the 1980s the attention of shipping policy makers particularly from developed maritime countries around the world was drawn more closely to the subject of shipping registration as many shipowners, attempting to improve their competitive position in tight shipping markets, moved their ships to what were commonly called open registers.

“Open registers” were flexible with regard to the ownership of the vessels that could be registered while “closed registers” required that the ownership rested in nationals of the country of registry.

Open registers were registers which did not have stringent ownership requirements and offered overseas shipowners the opportunity to improve competitiveness through access to lower operating costs. Open registers typically offered taxation free regimes and/or flexibility in crewing arrangements which enabled the employment of lower paid crew from developing countries.

In the late 1980s many developed countries, especially in Europe, found their national fleets to be shrinking in size as shipowners defected to open registers in pursuit of improved shipping economics. Shipowners operating under the conditions of their national register found it difficult to compete with open register ships and many simply moved to open registers in order to remain competitive.

The developed countries of the world reacted to the phenomenon of the open register and its impact on their national fleet in a number of different ways. Some countries, such as Australia and Japan, introduced shipping industry reform policies premised on the combination of increased use of technology and smaller crews, to lower operating costs. While these approaches certainly improved their fleets competitiveness, they could generally not close the gap with open register shipping with its zero taxes and low cost labour unless implemented in conjunction with measures such as direct subsidies and tax relief.

Other developed countries, especially those with long maritime industry heritages and significant onshore industries (such as ship repair, ship brokering and insurance) embraced the concept of a second international register. Countries such as Denmark, Norway, the United Kingdom and France introduced second international registers which operated outside the national taxation regime and often provided for the employment of foreign crew.

These developments in shipping registration have raised a raft of issues which impact on any country contemplating developing or expanding a national fleet or generally reviewing shipping industry policy. Modern shipping is an international and extremely competitive activity. If countries develop shipping registers which, by the nature of their requirements, do not encourage registration by nationally owned ships, then potential shipowners will either not enter the industry or will find a receptive open register that meets their requirements elsewhere.

International Protocols and Obligations

It is not the intention to provide here a detailed examination of all the detail and legal issues associated with shipping registration¹. Rather, this chapter will examine shipping registration as an adjunct to general shipping policy. It will look at the core requirements of shipping registration, as laid down by international conventions, and the extent to which effective administration of those requirements can impact on the performance of the register, both directly through attracting shipping to the register, and indirectly through the attractiveness of ships of the register to shippers around the world.

The framework for shipping registration

The basic principles relating to the nationality and registration of ships are found in the 1958 Convention on the High Seas and elaborated upon in the 1982 UN Convention on the Law of the Sea (UNCLOS III).

According to international law, each country has the right to determine the conditions which apply to the granting of nationality by providing access to its shipping register. This right is contained in UNCLOS III, which states that each State shall fix the conditions for the grant of its nationality to ships, for the registration of ships in its territory, and for the right to fly its flag. Ships have the nationality of the State whose flag they are entitled to fly. There must exist a genuine link between State and the ship.

UNCLOS III however, does not define the term “genuine link” and this has provided flags of convenience the opportunity to argue that the act of registration provides the genuine link between the country and the ship.

UNCLOS goes on to specify the responsibilities associated with the granting of nationality. Each State is required to:

- maintain a register containing the names and particulars of ships flying its flag;
assume jurisdiction under its internal law for each ship flying its flag and its master, officers and crew;
ensure safety at sea in respect of ships flying its flag by taking appropriate measures in regard to:

This topic is well covered in another ESCAP publication: Guidelines for Maritime Legislation (Third Edition), ST/ESCAP/1076)

-
- the construction, equipment and seaworthiness of ships;
the manning of ships, including labour conditions and training;
the use of signals, communications systems and the prevention of collisions.

UNCLOS also gives, a limited right to other countries to intervene when relevant rules are not observed:

A State which has clear grounds to believe that proper jurisdiction and control with respect to a ship have not been exercised may report the facts to the flag State. Upon receiving such a report, the flag State shall investigate the matter and, if appropriate, take any action necessary to remedy the situation.

UNCLOS effectively precludes dual nationality for a ship, stating that a ship may not change its flag during a voyage or while in a port of call except where there is a real transfer of ownership or change of registry.

International conditions of registration

While UNCLOS does not go into detail on the conditions governing registration, an attempt to spell out the rights and responsibilities of flag states and standards of accountability for ships and their owners and operators has been made in the 1986 U.N. Convention on Conditions for Registration of Ships (the Convention). The Convention applies to all ships of 500 grt or over participating in international seaborne trade.

While the Convention is yet to come into force² the intent of the Convention could usefully be taken as reflecting the standards expected for shipping register development in the longer term.

The Convention primarily aims to increase the accountability of States for vessels registered under their flags by encouraging them to exercise effective jurisdiction and control over their shipping. This is achieved by requiring a genuine link between a ship and its flag State through provisions relating to the ownership, manning and management of ships. Flag States must, for example, establish prescribed minimum levels of participation by their nationals and permanent residents.

² The Convention comes into force when ratified by 40 or more States representing at least 25% of world tonnage.

The Convention specifies the requirements for a public register and insists that each flag State must have a competent national maritime administration which ensures its ships comply with all applicable international rules and regulations.

The Convention also makes provision for the interests of labour supplying countries to minimize any adverse effects arising from its implementation.

The structure of a shipping register

It is normal for the national shipping register to be effected through legislation. Without going into detail, such legislation would be expected to include provisions relating to:

- the purpose of the register;
- the registrar and his functions;
- information to be kept on the register; and
- requirements in relation to applications, fees, the surveying of ships, manning, ownership, bare boat chartering, mortgages, the location of head offices, ship markings etc..

The precise nature of some of these requirements; for example in relation to manning and ownership, will be a matter for policy consideration.

One of the most important aspects of national shipping registration is ready public access to the register and its requirements. Details of the more efficient registers are increasingly becoming available from the office via the Internet.³

The Internet sites detailed below provides a useful showcase of public access models being developed by other countries: [Australia<<http://www.amsa.gov.au>>] [Hong Kong <<http://www.info.gov.hk/mardep/register>>] and [Singapore<<http://www.mpa.gov.sg>>]

Table 6.1: Ship registration in selected countries in ESCAP region

Country	National Register	Second Register	Title of registration
Australia	Yes	No, but actively considering	Shipping Registration Act 1981
Bangladesh	Yes	No, but actively considering	Bangladesh Shipping Ordinance 1983
Hong Kong, China	Yes	No	Merchant Shipping (Registration) Ordinance 1990
Indonesia	Yes	No	Indonesian Commercial Code & Act No. 21 of 1992
Iran	Yes	No	Iranian Maritime Code
Myanmar	Yes	No	
New Zealand	Yes	No	Ship Registration Act 1992
Pakistan	Yes	No	Merchant Shipping Act 1894 and Registration of Ships Act
Singapore	Yes	No	Merchant Shipping Act
Turkey	Yes	No	Turkish Ship Register
Viet Nam	Yes	No	Not known
Thailand	Yes	No, but actively considering	
Korea	Yes	Yes	National Register: Ship Act No. 3641 amended in December 1982 Second Register: International Vessel Registry Act, 1997
Philippines	Yes	No	Executive Order No. 125 as amended
Malaysia	Yes	Yes	National Register: Merchant Shipping Ord. 1952 Second Register: Malaysian International Shipping Registry - Merchant Shipping (Amendment) Act 1997
India	Yes	No	Merchant Shipping Act, 1958 as amended Merchant Shipping (Registration of Indian Ships) Rules, 1960 as amended
China	Yes	No	Regulations governing the Registration of ships 1994

Source: Data collected from questionnaire responses from participating countries

Meeting International Obligations in Practice

IMO standards and enforcement

There is increasing pressure on countries which operate shipping registers to meet their jurisdictional responsibilities in accordance with Article 94 of UNCLOS to ensure safety and environmental standards with the ships enrolled in the register. Specific standards which need to be met have been devised by the International Maritime Organization (IMO) and take the form of a number of conventions, well known by those involved in the shipping industry, such as SOLAS, STCW and MARPOL.

The same competitive pressures in the 1980s which led many shipowners to move to open registers or flags of convenience as cost reducing measures, also created an environment which inevitably resulted in an erosion in the quality of shipping. Low freight rates could not sustain the capital cost associated with new or replacement shipping and as a result the average age of ships in the world fleet trended upwards. While an older fleet required greater maintenance, cost pressures operated against that maintenance being forthcoming. At the same time regulators of open registers were faced with a conflict between their responsibilities in enforcing IMO safety standards and the profit making objectives of the registers.

Inevitably there was a spate of serious maritime incidents and the publicity associated with these, especially where oil spills occurred, combined with economic pressures arising from their impact on the insurance industry, has seen an increasing international focus on ship quality and safety.

Concerns at the extent to which IMO standards were not being met resulted in a system of Port State Control being developed in Europe in the 1980s whereby IMO member states inspected foreign ships visiting their ports for compliance with IMO standards. Ships which failed to meet the standards could be detained.

Port State Control has now spread to most parts of the world and is becoming increasingly sophisticated. Not only are more ships being inspected but inspecting countries are coordinating their records and adopting systematic approaches whereby ships of flags with poor records are targeted and individual ships are tracked to ensure their deficiencies are rectified. At the same time the insurance industry, at both the hull and P&I levels, has moved to link premiums with risk, with specific flags and classification societies being important factors in this equation.

Flag state response to quality demands

With increasing attention being paid to the policing of shipping standards and the track record of the flag becoming an important factor in register selection by shipowners, many registers have found that they now have to be in a position to substantiate any claims they make about the standard of ships under their flags.

This new consciousness of the need to pursue quality in shipping is reflected in the actions of a number of registers, especially open registers⁴:

- the Liberian and Marshall Islands registers have sought and gained International Standard Organization accreditation;
- the register of the Republic of Cyprus has hired more surveyors to scrutinize its ships following publication of lists of detained ships;

the register of Vanuatu, following an appearance on a United States Coast Guard black list, responded promptly to reports of its ships being detained and removed deficient ship from its register;

some registers such as the Isle of Man and Hong Kong have introduced strict entry criteria, refusing older ships and insisting on inspection prior to registration; and

some registers only accept surveys from nominated classification societies.

Implications for flag states

The increasing expectation that flag states will not only be signatories to IMO conventions but observe them, combined with increasing enforcement of IMO conventions, means that flag states should continually review the adequacy of the ship safety policies and enforcement standards associated with their registers.

⁴“A premium on competence”, Michael Grey, Lloyd’s List Maritime Asia, December 1995.

Failures in this area must ultimately result in the register being subject to constant international scrutiny and be reflected in restrictions in the routes on which such ships might operate, unless satisfying IMO standards, and the preparedness of shippers to commit cargoes to ships under that flag.

It is not sufficient for flag states merely to be willing to enforce IMO standards in relation to ships on their registers. They must also have resources with the necessary expertise if they are in practice to be able to apply the standards. Countries looking to fleet expansion through changes in shipping register policy should particularly be mindful of these matters.

The shipping register as a policy instrument

With some exceptions, it can be expected that the shipping register will normally be a vehicle for pursuing the national shipping policy objectives of a country.

For example, if a country has a broad policy objective of developing a national shipping industry with employment and other economic and downstream industry benefits, it may wish to offer financial or other support means to the national shipping fleet(s). The traditional register will be the instrument through which the maritime administration of the country defines the population of ships which qualify for the special benefits. Specific fiscal measures adopted by countries are examined in Chapter 8.

A country may on the other hand decide to adopt a policy of attracting overseas vessels to register in the country in order to create a revenue stream and generate maritime related economic activity. This policy objective can be achieved through the establishment of an open register.

Developed countries that wish to stem the tide of flagging out by national shipowners to attractive open registers may adopt a policy to establish second register.

The shipping register can also be an important policy tool in achieving policy objectives of safety of life at sea and protection of the marine environment. National rules, implementing such policy would usually apply to all ships registered coming within the purview of the countries ship registry. The different types of registers are examined hereafter to see how they can be effective tools in achieving objectives associated with the development of national tonnage and other maritime related activities.

The first (or traditional) register

Ownership

The key characteristic of a first register is that the register is normally restricted to ships owned or chartered by nationals of the country. The ownership provision is consistent with the 1986 U.N. Convention on Conditions for Registration of Ships requirement (discussed above) for a genuine link between a flag state and its ships.

The ownership restrictions take many forms. Some prescribe a maximum level of foreign equity. The Philippines register, for example, requires a ship to be owned or chartered by Philippines citizens or by a corporation with a minimum of 60% national ownership. The New Zealand and Pakistan registers by comparison require a minimum of 51% national ownership. The Iranian register does not have any ownership restrictions for tankers, but requires a minimum of 51% Iranian ownership for all other ships. Bangladesh requires 100% local ownership.

Ships owned by citizens, permanent residents and corporate bodies incorporated in Singapore may fly the Singapore flag. There is no restriction on ownership of the corporate body which can have greater than 50% foreign equity. The company must, however, have a paid up capital of at least 10% of the value of the first ship, subject to a minimum of S\$50,000 and a maximum of S\$500,000.

Ships owned by permanent residents and corporate bodies incorporated in, and having their principal business conducted in Hong Kong may fly the flag of the independent registry of Hong Kong. Prior to the establishment of its independent shipping registry, Hong Kong was a port of registry for the United Kingdom registry and it followed the requirements and standards of the British registry. The standards required by IMO conventions are applied and enjoyed in respect of the independent registry.

Where ships on the Japan register are owned by companies the head office is required to be domiciled in Japan and all the directors are required to be Japanese nationals.

Nationality of crews

The other major characteristic is restrictions in relation to the nationality of crews, although this may not always be the case. Often registers provide for crewing only by nationals. Countries in this group include India, Pakistan, the

Philippines, and Viet Nam. Islamic Republic of Iran requires a minimum of 50% of the crew to be Iranian after the fourth year of registration. The Republic of Korea allows up to six foreign crew on internationally trading ships and up to two foreign crews on coastal ships.

Malaysia allows foreign nationals to serve on Malaysian ships provided they have a permit obtained from the Marine Department. In Malaysia's case the foreign crew dispensation reflects a severe shortage of marine personnel. While the Australian and New Zealand registers do not have any legislative restrictions on crew nationality, in practice their ships are manned mostly by nationals or residents.

Table 6.2: Selected ESCAP country of domicile, showing fleets tonnage registered with national and foreign flags, as at December 1997 (a).

Country of domicile (b)	Number of vessels				Deadweight tonnage (000 tonnes)			
	National flag (c)	Foreign flag	Total	Foreign flag as % of total	National flags	Foreign flag	Total	Foreign flag as % of total
Japan	882	1,925	2,807	68.6%	20,295	68,959	89,254	77.3%
China	1,574	432	2,006	21.5%	22,148	15,833	38,031	41.6%
Hong Kong, China	101	506	607	83.4%	5,751	29,812	35,563	83.8%
Rep. of Korea	485	370	855	43.3%	9,341	15,537	24,879	62.5%
Singapore	439	253	692	36.6%	10,309	5,463	15,772	34.6%
India	369	75	444	16.9%	10,775	1,611	12,386	13.0%
IR of Iran	146	5	151	3.3%	6,099	185	6,285	2.9%
Malaysia	227	20	247	8.1%	4,418	132	4,551	2.9%
Philippines	337	13	350	3.7%	4,427	65	4,493	1.4%
Indonesia	466	94	560	16.8%	3,129	1,089	4,217	25.8%
Thailand	234	59	293	20.1%	2,469	1,166	3,635	32.1%
Australia	67	29	96	30.2%	2,744	493	3,237	15.2%
Total (12 countries)	5,327	3,781	9,108		101,905	140,345	242,303	
Percentage	58.5%	41.5%	100.0%		42.1%	57.9%	100.0%	
World Percentage	57.6%	42.4%	100.0%		42.0%	58.0%	100.0%	

Source: *Review of Maritime Transport 1997, UNCTAD.*

(a) Vessels of 1,000 grt and over.

(b) The country of domicile indicates where the controlling interest of the fleet is located in terms of the parent company.

The open register

As discussed earlier, open registers were developed in response to competitive pressures in shipping markets of a level that encouraged many shipowners to search for means of minimising costs. The open register emerged to meet this need with attractive characteristics of freedom to employ crew of any nationality, lenient legislation and beneficial taxation regimes, all of which offered opportunities to lower operating costs.

The country operating the open register generally does not need the shipping for its own purposes, and the primary objective of the register is a stream of income from registration and associated fees. Ships registered in an open registry can also provide an avenue of overseas employment for the countries seafarers. Most of the countries which operate open registers are relatively small in economic terms and the open register constitutes a substantial source of funds for the national economy.

As at 1980 the major open registries accounted for 31.1% of the total deadweight tonnage of the world fleet. By 1996 their share of the fleet had grown to 42.5%. Table 8.1 below shows the top seven open registers and the percentage of the tonnage owned by nationals of the flag state. A characteristic of open registers, the lack of an ownership linkage between the registered shipping and the flag state, is clearly illustrated in table 6.3.

Table 6.3: Major open registers, by tonnage, share of the world fleet, and level of national ownership, as at end of 1996

Country of register	Total tonnage(thousand dwt)	Share of world fleet (% of dwt)	Portion nationally owned (%)
Panama	126161	16.3%	0.0
Liberia	90916	11.2%	0.0
Bahamas	36267	4.6%	0.8
Cyprus	32750	4.3%	2.2
Malta	33714	4.3%	0.0
Bermuda	7384	0.9%	0.0
Vanuatu	1603	0.2%	0.0

Source: Review of Maritime Transport, 1998, UNCTAD

The second (or international) register

The second register arose as a response by developed countries to their fleets being flagged out to open registers in pursuit of improved competitiveness. The second register of a country generally has most of the characteristics of an open register, ie increased crew flexibility and access to more beneficial taxation regime (relative to ships of the first register). The major difference is that most of the tonnage is owned by nationals of the flag state.

The two largest second registers as at 1996 were the Norwegian International Ship Registry (28.8 million dwt) and the Danish International Ship Registry (7.2 million dwt). The share of tonnage owned by nationals under the two registers was 88.6% and 96.5% respectively. Other countries of note with second registers include Germany, the United Kingdom, France, and Portugal.

The concept of the second register would not seem, on face value, to offer many benefits to countries of the ESCAP region other than the developed countries, as most countries would already be relatively competitive on wage costs. The countries where the concept of the second register is either being examined or adopted in the region are examined below.

Australia

A Government appointed Shipping Reform Group released a report in March 1997 recommending the establishment of a second register to increase the competitiveness of Australian shipping. The establishment of the second register was also linked to a winding back of cabotage.

To be eligible for the second register, ships would be required to spend 25% of operational time on international voyages or operate primarily on a coastal route where a competing scheduled service was provided by foreign or Australian second register ships. Second register ships would benefit from exemptions from personal taxation for national crew, access to foreign labour, and accelerated depreciation.

The Australian Government is still considering this part of the report and has indicated that it sees progress in other areas of reform, e.g. the transition from industry to company employment, as important prerequisites to further shipping reform.

Republic of Korea

The Republic of Korea passed legislation for a Korean second register in July 1997 with the objective of improving the competitiveness of Korean shipping. Implementation of the new register was scheduled for May 1998.

Ships under the second register will have more flexibility in employing foreign seafarers and be subject to a more beneficial tax regime (still being negotiated) than that applying to first register ships.

Malaysia

Malaysia passed legislation introducing a Malaysian second register in November 1997. The new register is part of a policy programme geared towards developing the Malaysian shipping industry and increasing employment opportunities and technology transfer.

Features of the Malaysian second register are:

the corporation owning the vessel must be incorporated in and have an office in Malaysia;

the corporation can be foreign owned, but if listed on the Kuala Lumpur stock exchange then 30% of shares must be reserved for Malaysian nationals;

the ship manager must be a Malaysian citizen or corporation;

the company must have a paid up share capital of 10% of the value of the ship or RM one million, whichever is higher; and

tankers or bulk ships must be less than 15 years old, and other ships less than 20 years.

The shipping register and the balance of payments

Often there is a link mistakenly made between the national shipping register and the balance of payments. Typically countries nominate shipping policy objectives which involve reducing deficits on international trade in services arising from the carriage of imports/exports by ships of foreign countries.

While this can be a genuine and worthy objective/rationale under specific circumstances (discussion in Chapter 4) it is important to realize that what matters for balance of payments purposes is not the country in which the ship is registered, but the country of the person drawing the freight revenue.

This is an important consideration because a country with little maritime heritage or expertise can pursue an improved balance of payments objective without trying to establish or expand a register. It can achieve the same end tapping the resources and expertise of other maritime nations through national involvement in shipping operated under other flags and using ship management companies.

The utilisation of another register would allow a drawing upon the skills and experience of an established shipping regulator. The engagement of a third country shipping management company would at the same time allow the tapping of skilled shipping resources.

Because freight earnings accrue to the operator of a ship regardless of flag, while such a scenario could see some balance of payments outflows related to registration and management, these could be outweighed by inflows to the national ship operator. This is a policy scenario worth considering for any country with only embryonic shipping industry.

Factors that guide shipowners in flag selection

For the shipowner the selection of the flag of a ship is a crucial issue in a successful shipping business as the economics of running a merchant ship are closely related to its registration. Flag states (traditional and open registers) should thus be aware of the factors considered relevant by shipowners and their applicability to their registers. Only through gaining such an appreciation will flag states be able to understand shipowner perspectives in relation to their registers and tailor a register to meet their objectives.

Costs

The cost parameter has traditionally been regarded as the most important factor in register selection. If shipowners are not able to be reasonably cost competitive under a national register the chances are that they will flag out their ships. While the topic of competitiveness and operating costs is examined in detail in Chapter 3, it should be noted that shipowners will have regard to the total cost impact, i.e. the aggregate of crew costs, capital costs, registration costs, direct and indirect taxes, etc..

A study of Korean shipping undertaken in 1996⁵, prior to the introduction of the Korean second register, showed that Korean registered ships were at a substantial disadvantage on taxation compared to open registers. The annual taxation fees incurred by Korean ships were of the order of US\$450,000 per annum compared to less than US\$5,000 for the open registers. Taxation was defined to include national taxes, customs duties and local taxes such as registration fees.

It is understandable in the face of this data why around 40% of the fleet of the Republic of Korea was flagged out (see Table 6.2) and decision of the Korean Government to introduce a second register.

Crew restrictions

Shipowners require access to suitable and certified crew, both officers and ratings. If flag restrictions impede their ability to obtain crew (e.g. there is a shortage of the trained nationals required by a register) then there will be an incentive for shipowners to examine other flags.

Market access

Increased Port State Control activity, with a focus on flags with poor track records, has meant that ships under targeted flags can expect attention from safety authorities on routes such as Europe, Japan, North America and Australia. Regardless of the condition of their ships, owners may not welcome the time and money lost when being subjected to regular Port State Control inspections because of their flag.

Quality of the register

The quality of a register can be an important factor in flag choice. A study of shipowners undertaken in 1996⁶ in relation to the Isle of Man Register showed that there were two areas of a registers performance considered as important by shipowners, standards and efficiency.

High standards were associated with:

⁵ Flagging options for the future: A turning point in Korean shipping policy?, Tae-Woo Lee, Maritime Policy and Management, 1996, vol. 23, No. 2, 177-186l.
The influence of qualitative factors in Isle of man ship registration decisions, Kevin Cullinane and Mark Robertshaw, Maritime Policy and Management, 1996, vol 23, No. 4, 321-336.

the use of single authority to carry out flag state inspections;

a good safety record maintained by a competent administration taking full responsibility for surveys and adhering to IMO conventions;

quality and sensible inspections at a reasonable cost; and

a reputation for high standards.

Efficiency was associated with minimal regulation and maximum flexibility as reflected in:

freedom of nationality of crew;

low levels of bureaucracy, high levels of administrative efficiency and user friendly documentation;

the register having minimal input into the operations of the shipowner; and

efficiency of operational costs.

It should be borne in mind that these factors were seen as the desirable attributes of a second register. Nevertheless the survey does provide an insight into factors regarded as significant generally by ship owners in a register.

Patriotism

It would be expected that loyalty to the flag of the nation of the owner would be a relevant factor, all other things being equal. This is in part the rationale of the second register which provides an opportunity for ships to stay on a national register without being disadvantaged on cost competitiveness.

Relative importance of factors

For any particular ship it is likely that the ultimate choice of flag will be dependent on a range of factors. To the extent that there is an economic linkage between shipping markets and ship types, it is also likely that the range of factors will vary according to the trade the ship operates in, the ships type and its characteristics such as age and condition.

A twenty five year old crude tanker which is showing its age is, for example, likely to be a different flag proposition to a newly built container ship destined for the conference trades.

A study was undertaken in the United Kingdom in 1998⁷ to identify the relative importance of factors affecting the decision to use foreign flags for British shipowners. The study concluded that the most important factors were costs (52%), including crew costs (26%), compliance costs (12%), fiscal reasons (9%) and other costs (5%). Other major factors identified were control (17%), the availability of skilled labour (13%) and the trade in which the ship was to operate(5%).

Developments in ship registration: ESCAP region

Table 6.4 below, shows the fleet of ships over 100 gross registered tons registered in countries of the ESCAP region. As at the end of 1997 the ESCAP registered fleet accounted for around 21% of world tonnage.

Table 6.2, however, showed that only around 59% of ships with domiciles in ESCAP countries were actually registered in those countries. The remaining ships were registered under foreign flags.

In tonnage terms only 45% of the tonnage domiciled in ESCAP countries were actually registered in those countries. This means that the tendency to register with a foreign flag increases with the size of the ship.

Countries in the ESCAP region need to first determine the policy objectives that the national shipping register can help to achieve.

In the event that the policy objective is to promote the national fleet(s) then the policy makers must decide upon the ships that would be targetted for special assistance and this could be neglected in the criteria for registration. The fiscal and other support measures must be directed at assisting the national fleet to be internationally competitive.

Factors influencing the choice of flag: empirical evidence, Angela Bergantino and Peter Marlow, Maritime Policy and Management, 1998, vol. 25, No 2, 157-174.

If the shipping policy objective is to attract overseas tonnage to an open registry, or stem the tide of flagging out, then it is important that policy makers understand what makes a shipowner choose a particular flag. It will then be possible to make the countries shipping register attractive to shipowners/managers.

It is important for policy makers to strike a balance between the need to ensure compliance with international rules on safety and environmental standards and other national requirements, and to ensure reasonable compliance costs.

Table 6.4: Merchant fleets of the ESCAP region by flag of registration and type of ship(a) as at 31 December 1996 (in 000 dwt)

Country of Registration	Total fleet	Oil tankers	Bulk carriers	General cargo	Container ships	Other types
Singapore	29,537	13,894	8,013	2,700	3,379	1,552
Japan	26,049	9,954	8,413	3,114	954	3,613
China	24,085	3,256	10,980	7,080	1,711	1,058
Philippines	13,353	262	10,334	2,192	264	301
India	11,261	4,471	5,073	713	111	894
RO Korea	10,946	722	6,456	1,030	1,739	999
Turkey	10,670	904	7,721	1,689	90	265
Hong Kong, China	9,526	30	7,796	627	1,011	62
IR of Iran	6,182	3,601	1,703	728	2	148
Indonesia	4,150	1,364	537	1,812	86	350
Australia	3,649	685	1,755	99	117	994
Thailand	3,438	784	950	1,461	115	128
Vanuatu	1,847	22	1,034	387	0	404
Vietnam	1,098	35	151	678	0	234
DPR Korea	838	10	157	596	0	75
Pakistan	697	91	292	260	42	11
Bangladesh	582	99	9	452	0	22
Azerbaijan	498	234	0	103	0	163
New Zealand	396	102	17	74	0	204
Brunei	351	0	0	3	0	347
Sri Lanka	312	10	175	123	0	4
Tuvalu	82	0	0	24	0	58
PNG	66	4	0	51	0	11
Turkmenistan	32	5	0	15	0	12
Fiji	30	4	0	11	0	15
Tonga	15	0	0	11	0	4
Solomon Islands	7	0	0	3	0	4
Kiribati	7	3	0	3	0	1
Samoa	6	0	0	6	0	0
ESCAP	159,710	40,546	71,566	26,045	9,621	11,933
% of World Total	20.6%	14.9%	25.5%	25.1%	17.1%	19.0%
World Total	775927	272023	281011	103880	56108	62905

*Source: Review of Maritime Transport 1997, UNCTAD.
(a) Ships of 100 grt and over.*

CHAPTER 7: FISCAL REGIMES TO PROMOTE FLEET DEVELOPMENT

Fiscal support measures can relate to the acquisition of tonnage and to the operation of such tonnage. While financing schemes assist national shipowners to increase and upgrade their tonnage, favourable taxation and depreciation schemes would assist national fleets to become intentionally competitive.

Governments in the ESCAP region and elsewhere have used fiscal support measures as policy tools for the development of national fleets, and each country has its own justifications for doing so. Fiscal measures that amount to subsidies and go against internationally accepted practices could attract retaliatory measures from trading partners and should take into account multilateral instruments that would be negotiated through the WTO.

Ship owning and operating is a volatile and capital intensive business in which timing is crucial to success. A ship purchased at the right time can make a significant contribution to success in shipping operations.

Sources of ship financing

Following are some of the important methods of ship financing through bank loans and financing schemes.

Soft loan from a state-run bank or a quasi-governmental financial institution under a planned ship finance programme;

Commercial banks;

Loans guarantee

Subsidies and shipyard credit for acquisition and construction of a ship;

Bareboat chartering programme with purchase options;

Leasing (Finance lease);

Securitization of debt (the conversion of asset-backed income into packages of securities, which are offered to investors);

Corporate finance including equity finance.

In recent years there has been an increasing focus on how the shipping industry can more effectively gain access to necessary finance and particularly how shipping can be made more attractive in relation to equity finance.

Countries in Asia-Pacific region are faced with a scarcity of funds and a relatively weak financial infrastructure. Private shipping companies in the region are unable to raise funds in the local market and have to seek overseas loans to finance the purchase of ships. Resource constraints have often discouraged the pioneering spirit of those who wish to invest in shipping business.

Bank loans and financing schemes

Soft loans

Soft loans are directly linked to a planned shipbuilding programme formulated by the government to expand the national merchant fleet of the country. Such loans are normally extended to national shipowners (public and private) through a state run bank or a quasi-governmental development bank.

Developing countries in the region have shown interest in the establishment of a quasi-governmental development bank or a maritime bank, patterned after the maritime bank of advanced maritime countries.

Ship financing schemes vary from country to country. This chapter deals with some of the schemes adopted by countries.

Malaysia

Malaysia has adopted a policy position that it needs to quickly increase its national fleet in order to reduce the dependence on foreign flagged vessels. Thus it places high priority on the continued increase in the size of the national fleet. The present 7th five-year plan (1996-2000) is aimed at increasing the fleet to 900 ships with 7 million dwt.

Malaysia has applied two strategies to achieve this policy objective. One is the setting up of a bank, Bank Industri, to offer loans to local shipowners at a reasonable interest rate. The other one is the establishment of the Shipping Fund to stimulate the development of the Malaysian owned fleet and other attractive incentives.

Bank Industri

Bank Industri was the first bank in Malaysia to move into financing related to the shipping industry. Their core business is the financing of ships, shipyards and maritime-related activities. The government allocates funds to Bank Industri through its 5-year plan.

Local shipyards are given the first option of building the ships required. In the event that the local shipyards are not in a position to build the ships, the shipowners are permitted to purchase from overseas shipyards.

The shipping fund

The shipping fund totalling RM 800 million was established by the Government of Malaysia, through the Bank Negara, in 1992. The two main components of this fund are the Ship Financing Facility (SFF) and the Shipping Venture Facility (SVF). When the fund was first established, Bank Negara chose Bank Industri as the managing authority of this fund. The SFF programme initially envisaged the provision of funds for acquisition of new and second hand vessels and a sum of RM 300 million was set aside for this task.

In 1994, the Government increased the shipping fund from RM 800 million to RM 1.1 billion and the amount allocated to the SFF programme was increased to RM 600 million. The boundaries of the SFF programme was widened to include not only the purchase of new and second hand vessels but also the construction of facilities to build and repair ships.

Bank Industri as the managing authority for the SFF programme has disbursed funds for the purchase and building of vessels plying domestic routes, international routes and shipyard facilities.

The Shipping Venture Facility (SVF) was allocated RM 500 million. The Central Bank of Malaysia utilized RM 300 million to set up a shipping company, Global Maritime Venture Berhad (GMVB), in March 1994. It appears that the RM 500 million allocated to the SVF was to be made up through a contribution of RM 200 million by the Bank Industri and RM 30 million from other financial institutions.

Table 7.1 below gives a summary of the financing programmes of Bank Industri.

Thailand

The shipping fund established by the Government of Thailand totalling Baht 8 billion has helped the purchase of eight ships. The fund assists shipowners to finance 20% of the purchase price.

India

The Shipping Development Fund Committee (SDFC) provided substantial support to the development of the Indian fleet during the period 1959-1987, the fund financed over 90% of the total national tonnage.

With the abolition of the SDFC in 1987, the financing of ships now has to be at commercial rates which have been higher than the rates provided by the SDFC or loans provided by OCED.

Commercial bank loans

Although shipowners can finance in a number of currencies it is usual to do so in United States Dollars, partly because of the credibility attached to the US\$ and the fact that the shipowners costs/revenue is usually determined in US\$.

In the case of a commercial loan, a bank usually demands a first mortgage on the ship as collateral or security for the loan. The loan amount would normally not exceed 80% of the purchase price of a new vessel and is usually around 50%. The loan period is around 8-15 years with a certain grace period and semi-annual repayments.

Table 7.1: Financing Programs through Bank Industri's Fund, Malaysia

Facility	Interest Rates	Repayment Period	% Or Amount Of Financing
New Vessels	9% p.a.	max. 10 years	max. 75% of contract price
Second hand vessels	9% p.a	Vessel less than 17 years	max 65% of value of vessel
Ship Operation Revolving Credit	9% p.a	12 months	max RM500,000 per vessel
Line of Credit	9% p.a	Age of vessel should not exceed 17 years	max 65% of intrinsic value of vessel
Guarantee	1.5% p.a	10 years	75% of vessel cost
SHIPYARD			
Shiprepairs Facility	6%p.a	6-12 months	max 80% of invoice value
	max 9%p.a	max 10 yrs	based on requirement and cashflow
Performance Bond	0.75%-2.5% p.a	max 18 months	max 25% of contract value
Refund Guarantees	1%-2% p.a	Duration of construction	max 90% of construction cost
Boat Building	9%p.a	max 10 yrs	based on boat builder's requirement and cashflow
Contract Revolving Credit	Fixed rate of 9% p.a (BI's funds) of KLIBOR plus a max margin of 4%	6-12 months	max 80% of contract value
Contract Bidding Bond	1%-2% of the contract bidding bond value	From its issuing date to the termination of the contract	min RM50,00 and max of 30% of Bank's shareholders' funds
Industrial Hire-Purchase		max 8 yrs	New-max 85% of price Used/ Reconditioned - max 75% of market value or price which ever is lower.
MARINE RELATED ACTIVITIES			
Term Loan	9% p.a on reducing balance	Based on project cashflow	Based on operators' requirement and project cashflow
Bank Guarantee For Licensing	1% of guarantee amount	max 2 year	Based on Custom's requirement
Industrial Hire Purchase	Flat rate of 5% p.a	max 8 year	New-max 85% of purchase price. Used/Reconditioned-max 75% of market value or price which ever is lower.

Note: ¹ Consist of both international and domestic shipping

Source: Bank Industri

Source: Malaysian country report

The interest rate on ship loans dominated in US\$ is usually expressed as LIBOR (London Inter Bank Offered Rates), plus “spread” that is dependent on the borrowers credibility. When ship financing is made in key currencies such as US\$, foreign exchange risks should be taken into account carefully. Devaluation brings about a steep rise in the cost of borrowing because borrowers have to pay more to service their debt in local currency. This is one of the factors that have aggravated the financial problems caused by the Asian economic crisis in 1997.

Loan guarantees

Where shipping companies in developing countries have difficulty in raising funds through local channels, and seek funds from overseas, they may need government guarantees to give confidence to the overseas lenders.

In the United States of America, the Maritime Guaranteed Loan (formerly known as the Federal Ship Financing Guarantee Programme) was established under the Title XI of the Merchant Marine Act 1936, as amended, to authorize the government to issue private sector loans or mortgages made to finance or refinance construction or the reconstruction of American flag vessels. Title XI was mainly aimed at promoting the construction of new vessels by the national shipyards. The program has played an important role in the development of the national fleet.

The major components of the programme are as follows:

Guarantees are applicable for the construction, reconstruction, reconditioning of commercial vessels at US. shipyards.

Shipyards modernization projects and refinancing of these types of projects.

Maximum of 87.5 % financing up to 25 years depending on the nature of the project.

In the event of default by the vessel owners or general shipyard facility, the government guarantees full payment to the lender of the unpaid loan sum and interest.

According to the 1997 Annual report prepared by the US Department of Transport, as of September 1997, the aggregate guarantees provided by the United States Government amounted to US\$ 2.6 billion.

In Switzerland, loan guarantees can be granted by the government for the finance of Swiss flagged ships when they are needed for carriage of goods to Switzerland. The loans guaranteed by the government may not exceed 85% of the ship building costs or purchased cost of each vessel.

Subsidies and shipyard credit

The United States of America adopted the Construction Differential Subsidy (CDS) as discussed in Chapter 2 for the purpose of development of the national fleet and the ship building industry but terminated the subsidy in 1981.

Bare boat chartering with purchase options

Some countries have concentrated on allowing bare boat chartering with purchase options to encourage ship owning in view of the large capital required for vessel acquisition.

A bare boat or demise charter with purchase options arises when a ship operator hires the bare ship from a ship owner, finds his own crew and operates as if the owner. The charter would normally be for a long period of time and in some cases the entire life of the ship. The owner of the vessel bears the capital costs while the charterer bears all the operational costs including maintenance of the ship. The charterer pays the ship owner a hire fee calculated on a daily basis but usually paid monthly in advance. Possession of the vessel is transferred from the owner to the charterer (this explains the term “demise charter”) at which time an on hire survey is carried out.

International and national law allows the demise charterer to register the vessel in a country of his choice.

Bare boat chartering may be a less expensive option to vessel acquisition, particularly for developing countries. Local operators may require governmental support by way of guarantees if purchase options are included in the charter party. For example, in the Republic of Korea bare boat charters with purchase options contributed to the increase in the number of vessels in the national fleet in the 1970's and 1980's.

In the Philippines the development and maintenance of a national fleet which could participate in the international trade of the country has been hampered by the problem of financing the acquisition of ships. In 1976, the government extended its bare boat chartering programme applicable to domestic shipping to international shipping.

Under the programme, any foreign owned vessel under charter or lease to a Philippine national and satisfying certain criteria may be issued with a temporary certificate of registration.

The certificate is issued subject to the following conditions.

The charter or lease was valid for period not less than one year.

The registered vessel was manned entirely by Philippine crew.

The ship operator can charter up to 7 vessels for each owned vessel.

The shipowner was required to increase the paid up capital and produce proof of management and operational control of bare boat chartered vessels.

Lease purchase

Lease purchase is comparable to a bare boat chartering programme with purchase options. The lessor, or the lender (normally a leasing company or a commercial bank) purchases the title to the vessel in question and sells this right to the lessee or the borrower in exchange for a regular and equal payment.

Securitization of debt

Securitization of debt is a financing scheme which facilitates the acquisition of funds from individual investors who in turn enjoy tax concessions relating to personal and corporate tax.

Funds are collected from individual investors (partners) through the formulation of a consortia (limited partnership.) Once the consortia purchases the vessels it is leased or chartered to prospective shipowners/operators.

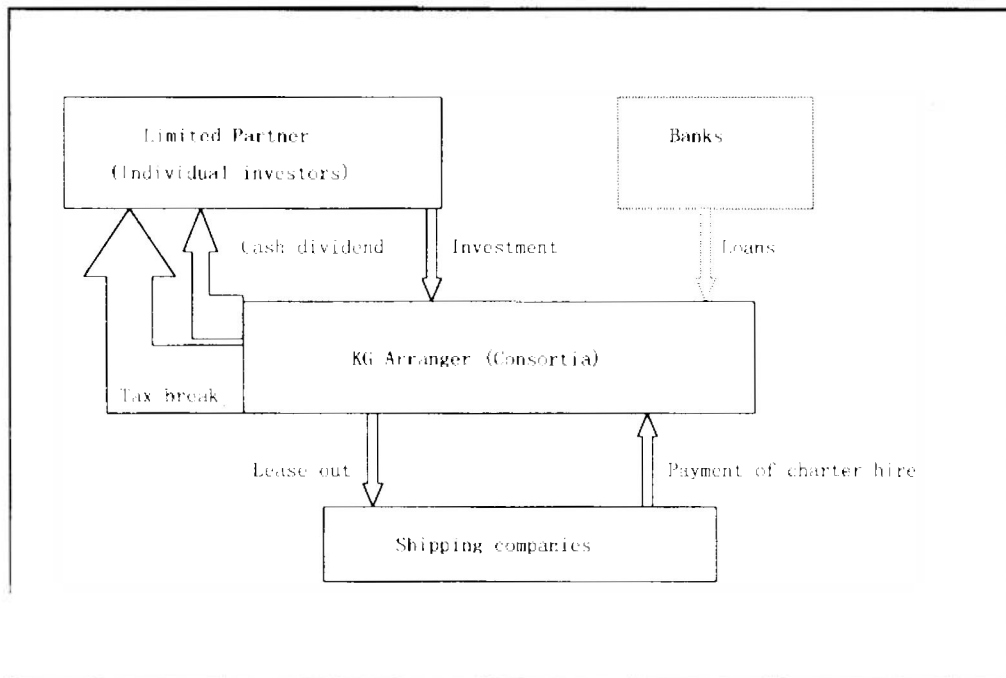
The scheme which was first designed in Norway is referred to as K/S (Kommanditt - selskap). Each consortia partner need only contribute a small amount of capital while the tax benefits would be substantial.

A similar type of scheme has also been in operation in Germany and its structure is illustrated below. The KG scheme as it is known has been utilized to acquire new full container vessels from Korean shipyards and has been reputed as a successful portfolio investment.

In France an aid programme formulated in 1998 for merchant vessels under the French flag is similar to the German scheme. Under this scheme, shipping companies have the opportunity of acquiring the ships after 5 years of operation. Investors have the benefit of being exempt from tax on capital gains when they sell their interest.

It is anticipated that financial creativity and a range of financial instruments including long term charter parties will play an increasingly important role in the finance of ships in the future.

German KG Scheme - Diagram



Corporate finance

Corporate finance is an integrated finance method which is different from particular project finance. Global shipping companies can tap a variety of direct financing such as corporate bonds or medium term notes (MTNs) or equity linked finance through capital markets. Typically corporate bonds have a maturity of between 5 to 10 years with either fixed rates or floating rates through capital markets. To issue such bonds on public placement a corporation has first to obtain a rating classification from a reputed private rating agency and list its shares on the stock exchange of the market concerned.

Ship financing schemes in the ESCAP region

Philippines: Two-step loan based on OECF fund.

The domestic shipping modernization programme in the Philippines is a financing scheme to promote the efficiency and safety of the domestic shipping industry through the Development Bank of the Philippines (DBP) the executing agency of the programme.

The programme is designed to support investment in domestic shipping and shipping related companies which intend to modernize their operations through the replacement of their aged vessels and the renewal of related equipment. The loans are provided through a credit facility established by the Overseas Economic Corporation Fund (OECF) a Japanese quasi-governmental institution.

The OECF has extended a credit facility denominated in Japanese Yen to the DBP as the re - lending bank, which in turn lends to eligible borrowers. Such borrowers would be companies engaged in domestic shipping and shipping related industries. Although the OECF lends the money to the DBP in Japanese Yen, the DBP lend to the Philippine borrowers in Philippine Pesos. Thus the scheme is dubbed the two-step loan.

Eligible projects include the following.

Acquisition of second hand vessels or new buildings in order to improve or expand the business

Conversion or modification of vessels

Upgrading of technical standards of vessels or bringing a vessel into class

Shipyard modernization or expansion

Modernization of cargo handling and related terminal facilities

The terms of the two-step loan scheme are as follows:

Loan amount - up to 80% of the related project expenditures

Loan period - 3 to 15 years with a grace period of 5 years

Annual interest rate:

Variable Rate (VR): Variable rate of Weighted Average Interest Rate (WAIR) less 2% p.a. but not lower than 12% reviewable every six months.

The WAIR is calculated on the basis of 91 - day Philippine Treasury bills during the 3rd and 4th weeks of the second month and the 1st and 2nd week of the month preceding the reference quarter.

Fixed rate

Term for 3 years:	VR +2.0%
Term over 3 - 5 years:	VR + 2.5%
Term over 5 - 8 years :	VR +3%
Term over 8 years:	VR +3.5%

Import duties

Import duty can significantly affect the initial acquisition cost of a ship. Import duty concessions are, therefore, one of the major fiscal measures utilized in developing countries where there are no shipyards for the construction of new vessels. The following table illustrates the duty concessions in selected countries in the ESCAP region.

Table 7.2: Exemption of import duties

Country	Contents
India	exempt
Malaysia	exempt for a ship over 4,000 grt but normally 30% duty levied on a ship less than 26grt 10% duty levied on a ship with 26-4,000grt
Pakistan	exempt
Philippines	exempt for oceangoing shipping exemption from import duties had been extended to the domestic shipping industry under the Investment Priorities Plan of the Omnibus Investment Code of 1987
Thailand	exempt

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CHAPTER 8: REVITALIZING NATIONAL SHIPPING LINES – PUBLIC SECTOR AND PRIVATE SECTOR PARTICIPATION IN SHIPPING

Access to cargo, ship registration and fiscal support measures can be effective strategies only in the event that the national shipping companies have a sound financial base, an efficient management and a motivated work force.

As public sector participation in shipping business gives way to the private sector, governments in the ESCAP region need to examine the most appropriate forms of such participation and ways in which national shipping companies could be revitalized.

A rationale for public sector participation

The popular philosophy in developed countries, which is reflected in public sector downsizing and the privatization of government business enterprises, is that where possible public services should be outsourced and the government should not be in direct competition with the private sector in commercial activities. It is viewed that such services, including the provision of infrastructure, can most efficiently be provided by the private sector subject to the competitive pressures of the market place. The governments primary role is seen as being limited to the promotion of fair and effective competition.

This philosophy is, however, not necessarily readily applicable in the case of developing countries where often the private sector does not have the expertise, management and technical skills, trained resources, or access to funding to undertake infrastructure activities. Under these conditions direct participation by government, at least initially, may be the only way the infrastructure development necessary to achieve increased productivity and economic growth will occur.

Ultimately the national economy will reach a state of development where the private sector will have the capacity to undertake the provision of infrastructure services initially provided by the government. When this occurs the government may wish to review its continued participation in the direct provision of infrastructure services. Any such review should be undertaken with a clear appreciation of the range of divestment options available and the macroeconomic and microeconomic outcomes associated with those options. A range of possible objectives is discussed further below in the section on privatization. The approach to privatization is likely to vary from country to

country, and from infrastructure to infrastructure, depending upon the objectives of the governments and the economic and political factors prevailing at the time.

It should not be assumed that privatization will necessarily result in increased efficiency, although this can often be the case. A major argument in favor of privatization, that the public sector is inherently inefficient, is ironically often made by those who have actually had the job of running the government enterprises as efficiently as they can. Sometimes greater efficiency and lower costs are simply a result of more competent administration or because the enterprises were used as defacto taxing agencies with excessive fees and charges.

Rationales for government participation in shipping services

This section is restricted to examining situations where a national government has a controlling or equity interest in a shipping enterprise or accepts liabilities associated with a specific shipping enterprise. Public participation is not regarded for this purpose as including involvement through assistance or other measures which have industry wide application such as direct subsidies, beneficial fiscal regimes, or ship building or purchase assistance measures. Such industry measures are considered in Chapter 9.

A range of scenarios, not necessarily mutually exclusive, are examined below which envisage circumstances under which Government participation in the provision of shipping services might be contemplated. It would be expected that these scenarios would fall within the range of national fleet issues discussed in the broader context of overall shipping policy objectives in Chapter 4 above. The difference here is that the objectives are being considered in the context of government participation being necessary to achieve the objectives. It will be seen that most of the scenarios fall into two categories, social equity or market failure.

Ensuring the availability of sea transport services

If the private sector is either unable or unwilling to provide sea transport services which are regarded by the national government as an essential part of the national transport system, consideration may need to be given to the government assisting with the provision of those services.

These circumstances might arise if, for example, the private sector was unable to raise the necessary capital, either locally or abroad, to finance ship purchases. One policy option would be for the government to provide the services until the private sector was capable of entering the market in its own right. A government may either have the necessary funds or, with its sovereign

guarantee, be able to access funds when the private sector cannot. The government may also be able to assist a private company to raise capital through an implicit government guarantee.

Another scenario is that the capacity of potential users to pay for required shipping services might be so limited that the services are not commercially viable for the private sector. This is a situation which occurs, even in developed countries, when the cost of providing basic services such as telephone, roads and other infrastructure, especially to regional areas, is of a level that cost recovery from users is not feasible. The need to provide basic services under these circumstances is often described as a “community service obligation” (CSO). One option for meeting the CSO is for government to provide or fund the services directly. Approaches for reducing the cost to government of providing such services are discussed below.

India’s objectives for public participation in shipping

The Indian Government originally took the initiative in developing a national fleet because the national fleet was inadequate to meet the nations trade requirements and the private sector did not have the resources to acquire a large number of vessels.

The carriage of crude oil is seen as being in the country’s national interest and primary responsibility for its carriage is entrusted to the Indian national line, the Shipping Corporation of India Ltd.

The types of shipping services which might be regarded as falling into the essential category are as follows:

inter-island or interregional domestic shipping where the shipping services constitute essential social, communications and supply links to the outside world;

general user cargo services providing essential feeder linkages to transport hubs and mainstream international shipping routes; and

specialized shipping to meet essential import or export resource transport needs.

Introducing competition

In markets where there is a lack of effective competition a government shipping enterprise may be contemplated as a means of introducing competition. This situation is more likely to happen in domestic markets subject to the entry barrier of cabotage than in international trades. If a government shipping enterprise is introduced it is important that it should not have any unfair market advantage over its private sector competitors in the form of the subsidies.

Obtaining balance of payments benefits

In the absence of a national fleet of substance, a government shipping enterprise may be contemplated as a means of reducing the perceived impact of the reliance of foreign shipping on a country's national accounts.

Research has shown that national shipping can make a positive contribution to the balance of payments provided that it is profitable. *Reference: Australian Shipping and the Balance of Payments*, Occasional Paper 99, Bureau of Transport and Communications Economics. In these days of strong competition in international trades, when many nationally owned shipping lines are struggling, a government shipping enterprise needs to be competitive and efficient if it is to be viable.

The international account objective has already been discussed earlier in Chapter 4. The issues raised there in respect of national flag shipping, e.g. the relative efficiency of foreign exchange earners, apply equally to a government shipping enterprise established for this purpose.

Developing a national industry and/or human resource base

For a country with only a limited shipping heritage and with only an embryonic shipping industry, deficiencies in trained human resources and shipping operational and management expertise can be a substantial impediment to the development of its fleet.

Under these circumstances the early involvement of the government in shipping, such as through a government owned shipping corporation, could provide a nursery for developing the human resource skills necessary to support a national fleet. At the same time this initiative could result in the development of the shipping market to an extent that it will encourage later private participation either trying to emulate its success or as suitors to a privatization process.

Facilitate national resource or project development

Where national resource projects are involved, such as the exploitation of mineral or petroleum resources, there may be opportunities for government involvement in the provision of necessary transport infrastructure, including shipping. Depending on investor perceptions of project risk and rates of return, government involvement may even be a factor in the viability of individual projects.

Forms of involvement in shipping

There are a range of participation options which policy makers may consider depending on the state of development of their economy, their capital markets, and their transport markets and systems.

Malaysian national line objectives

The Malaysian International Shipping Corp., (MISC), Malaysia's first national line, was incorporated as a public company in 1968. The Government's objective in setting up MISC was to reduce the nation's dependence on foreign shipping, minimize balance of payments outflows for shipping services and inhibit conferences ability to impose freight rate increases detrimental to Malaysia's exporters.

Malaysia established a second national line, Perbadanan Nasional Shipping Lines (PNSL) in 1982 to assist in developing a balanced and diversified fleet, to increase the presence of the national flag in order to achieve greater control of exports and imports, to diversify into marine related industries such as of shore support services, and to develop in-depth knowledge and expertise among Malaysians in shipping and related activities.

Providing shipping services from general revenue

The most simple form of public participation is through the direct payment for shipping services from the public purse on an ongoing basis. This could occur through giving a government department the responsibility for providing shipping services from its budgeted funds. The department would have the option of providing the services itself or contracting the work out to the private sector.

A government shipping enterprise

Another option is to create a government trading enterprise to provide the shipping services. Such an enterprise would require appropriate levels of start up capital to assist in meeting set up costs and the acquisition of vessels, and to meet initial operating expenditure until such time as the organization was self sufficient.

Consideration would also need to be given to the structure of the enterprise and possibility of incorporation. If it is intended that the enterprise should operate commercially and on an independent basis the incorporation option will expose the business to corporate business disciplines, and corporate law and reporting obligations.

If the government wishes to have more say in the day to day operations of the business it may consider establishing the business as a statutory authority with direct responsibility to a government Minister.

Public/private sector partnerships

If there is pressure on funding or a shortage of expertise, another approach is to consider private sector participation in the financing, management and operation of the shipping services from the start.

A partnership between the private and public sector to provide shipping services could take various forms, depending on the mix of private sector funding, skills and management capability required:

leasing/management contracts where the public sector provides the ships and the lessee operates and maintains them for the duration of the lease in exchange for a revenue stream;

build-operate-transfer (BOT) where the private sector was given the right to establish and operate a shipping service for a specific period with ownership reverting to the government at the end of the contract; and

joint ventures where the government and private sector variously contribute assets, resources, technology, management and operational expertise to the shipping project, with equity contributions and profit sharing in proportions agreed by the venture partners.

Policy makers interested in further information on public-private sector partnerships for infrastructure development are referred to the ESCAP paper. *Major Issues in Infrastructure Development: Public-Private Sector Partnerships.*¹

Achieving efficiency in publicly owned or controlled shipping

When decisions are made about whether public participation will occur in an activity such as shipping, too often the focus is on the need for the participation and not how to ensure that efficiency of operation and the return on public investment is maximized. This oversight is especially important in situations not subject to competitive market pressures.

In its 1997 report to the Australian Government *Reference: Pathway to public sector best practice*, the Australian Financial Review, 13 September 1997, the National Commission of Audit noted that there were three principles which should be addressed in relation to public participation.

Assess whether or not there is a role for government:

Where there is, decide which level of government and assess whether or not government objectives are clearly specified and effectively promoted; and

Assess whether or not effective activities are being conducted on a best practice basis.

Observance of these principles by policy officers implies ongoing attention to ensure that the policy rationale and objectives behind public sector participation in activities such as shipping need to be revisited regularly to assess continuing relevance and the meeting of objectives. At the same time the manner of public sector participation needs to be monitored to ensure efficiency.

Evaluating policy

One approach to assessing the success of policy is to undertake, as a matter of course, policy evaluation programs. Typically in such programs there is a comprehensive examination of policy outcomes relative to the stated objectives. Where policies involve recurrent budget expenditure there are opportunities for this process to occur as part of the annual budget process where competing priorities for funds force central funding agencies to attach priorities to expenditure for government consideration.

E/ESCAP/SGO/MCI/4 of 13 August 1996.

The budget approach in terms of public participation in shipping would only effectively work where shipping services are provided directly from the budget through, say, the provision of inter island ferry services on a community service basis.

The substantial sums of capital associated with ship acquisition results in public participation in the provision of shipping services commonly being provided through public authorities or companies operating on commercial lines. For such an organization the budget approach will not normally suffice and a more substantial review is required. A review like this also needs to examine not just whether policy objectives have been realized, but also the efficiency of the organization in pursuing the objectives.

A model for oversighting government business enterprises

In 1997 the Australian Government introduced the Commonwealth Authorities and Companies Act and Governance Arrangements for Commonwealth Government Business Enterprises. Together these regulations provide a framework for performance for public trading enterprises which leave them in no doubt as to government expectations in relation to efficiency and performance and at the same time provide, through reporting arrangements , mechanisms for government to monitor their performance and behavior.

It has been suggested that these regulations exceed the requirements applying to businesses under corporate law. However given that the primary reasons for government involvement in activities such as shipping are social equity and market failure it is perhaps not be unexpected that normal private sector commercial disciplines will not suffice.

Regulation parameters

Important features of the new Australian regulations are that they clearly define the relationship between the government and the enterprise, and the roles and responsibilities of the relevant minister (representing the public as shareholders) and officers of the enterprise.

The regulations also specify reporting requirements including an annual report with relevant financial statements, a corporate plan, and a statement of corporate intent agreed by the enterprise and Minister.

A measure of the comprehensiveness of the new regulations is provided by the corporate plan which must cover three years, be submitted annually and include:

the objectives of the enterprise;

assumptions about the business environment in which the enterprise operates:

the business strategies for the enterprise;
the investment and financing programs of the enterprise, including strategies for managing financial risk;
financial targets and projections for the enterprise;
the dividend policy of the enterprise;
non-financial performance measures for the enterprise;
community service obligations for the enterprise and the strategies and policies the enterprise is to follow to carry out those obligations;
review of performance against previous corporate plans and targets;
analysis of factors likely to affect achievement of targets or create significant financial risk for the enterprise or the Commonwealth;
price control and quality control strategies for goods or services supplied by the enterprise under a monopoly; and
human resource strategies and industrial relations strategies.

Assessment of public enterprise performance in India

In India there is a Memorandum of Understanding (MOU) between public sector enterprises and the Administrative Ministry. Under the MOU system targets for performance are fixed for the ensuing year against which performance is evaluated.

Public enterprises are also subject to examination by a Parliamentary Committee on Public Undertakings which examines their functioning and can recommend measures for performance improvement.

The Government of India has also introduced measures to free public enterprises from excessive and counter productive rules and regulations. Selected high performing enterprises can be granted a special status (Mini-Ratna) which confers greater autonomy. As a Mini-Ratna the Shipping Company of India would have more powers in decision making with regard to capital investment, forming joint ventures, setting up offices abroad, etc..

The integrity factor

Shipping as an international trading activity is particularly vulnerable to corrupt practices. Public participation in the provision of shipping services can only be efficient and cost effective if it is free of such practices.

The Chairman of Transparency International UK, an affiliate of Transparency International, a non-profit making organization set up in 1993 to counter corruption has noted that:

There has been a huge deterioration in the last ten years, with grand corruption becoming the general rule rather than the exception in major government influenced contracts.

Contracts to sell aircraft, ships and military supplies including telecommunications have always had the strongest potential for large scale corruption. *Reference: Kicking the kickbacks, the Australian, 13 June 1997.*

The new Commonwealth Authorities and Companies Act in Australia requires an officer of a public enterprise to act honestly at all times in the exercise of his powers and duties and provides for civil penalty provisions including up to 5 years jail.

Privatization of public shipping enterprises

The topic of privatization is one that has attracted considerable discussion, research and public comment over the past decade, first as a rationale was sought for the rush to deregulation by the governments of the developed world in the mid 1980s and more recently as part of a more tempered re-evaluation of the objectives of the process building on earlier experiences.

It is not the task of this section to undertake a detailed examination of the privatization concept. Rather an attempt is made to convey an awareness of the central issues and themes which should be examined by policy makers in the context of formulating national shipping policy.

The objectives of privatization

The privatization of public shipping services will normally only become a policy option once the private sector has developed the capability of providing those services.

The motivation for examining the privatization option for any government business enterprise will come from a range of possible macroeconomic outcomes. These outcomes include:

Impact on the budget

If a government business enterprise is relatively inefficient it may need to call upon the state to underwrite its operating losses or provide capital injections to support its equity base and facilitate expansion or asset replacement. In the absence of an adequate equity base the government business enterprise may also have a gearing level (debt to equity ratio) which leaves it at an operating disadvantage (in terms of debt servicing) compared to its private sector counterparts.

The state therefore finds itself in a dilemma. If financial support is not provided to the business, effectively as an equity injection, it will probably need to borrow funds thereby exacerbating its gearing difficulties and losing value at the same time. Utilization of public funds for this purpose, however, may run counter to government priorities for using scant budget revenue.

A privatization process which effectively absolves the government of any further financial responsibility for the government business enterprise can provide the answer to this dilemma.

Windfall sale proceeds

Privatization in the form of a sale may provide the government with one off sale proceeds which can be used for a range of purposes, including the reduction of public sector debt. Policy makers should be careful that the incorporation of privatization proceeds in budgets does not mask the need for attention to recurrent fiscal deficiencies.

The removal of market distortions

It may be that the government business enterprise has an unfair advantage over its private sector counterparts and is distorting development of the shipping market. Advantages can arise from access to cheaper funds (a product of an implicit government guarantee), from the lack of a dividend obligation to shareholders or the need to provide a return on equity, or from exclusive access to government cargoes.

Privatization would remove this distortion and provide for fairer competition in the market to the benefit of all users.

Wealth redistribution

Another policy outcome that may be sought from privatization where a government business enterprise is performing well and generating a budget revenue stream is the redistribution of wealth through equity issues. Such outcomes can allow broad public participation in the industry (and the sharing of wealth) while at the same time introducing corporate and/or free market culture pressures to bear on the operation of the enterprise.

In a developing country where the distribution of wealth is heavily skewed this approach arguably may not lead to wealth redistribution but to concentration. In this case a more equitable distribution may be obtained by leaving the enterprise in public hands so that any revenue or dividends are returned to the government and all the people.

Microeconomic benefits

Apart from the macroeconomic objectives there can also be microeconomic objectives. It may be recognized that the private sector is simply able to provide shipping services more efficiently and/or at lower cost than an existing government business enterprise. Under these circumstances privatization may be a policy option which has both macroeconomic and microeconomic benefits.

Regardless of the benefits identified with a potential privatization caution still needs to be exercised before proceeding. In thin markets where there are few shipping operators, privatization by a sale may leave shippers in the hands of an operator in a position to abuse market power. Other privatization approaches, discussed below, can however, avoid this situation.

Another potentially negative outcome is that, once privatized, the philosophy of the enterprise will almost certainly focus on the pursuit of profits and maximizing of favourable commercial outcomes. This environment is unlikely to be sympathetic to the cross subsidization of users or perseverance with uneconomic services regardless of their strategic or social values.

Approaches to privatization

While there are many ways of privatizing a government business enterprise they can probably be categorized under three broad headings.

Complete transfer of ownership and control

A complete transfer of ownership and control can be achieved in a number of different ways, depending on the characteristics of the entity being sold and its marketability.

A “trade sale”, using auction or tender processes, is often used when the expected sale price of the enterprise being sold would only see a limited number of potential buyers and the possible absence of bidding pressures to maximize the price received.

A trade sale will normally involve an extensive process, entitled due diligence, whereby the seller undertakes a comprehensive review of the business for the benefit of potential buyers covering matters such as the financial history of the business, the nature and condition of its physical assets, its financial condition (including details of debt and liabilities), the markets being served by the business and its prospects. An essential element of the sale process, if the results are not to be challenged, is total transparency. A lack of transparency, if foreign investors are involved, could impact on the country’s reputation for foreign direct investment purposes.

It is valid as part of a trade sale, especially when critical infrastructure is involved, to seek to ensure that potential buyers have the necessary expertise and management skills to operate the business.

If the government has concerns at the impact of a trade sale on the provision of essential services to uneconomic sectors it can include community service obligation clauses in the sale conditions. These clauses could prescribe routes to be served and include price control mechanisms. Care needs to be taken that the inclusion of such clauses does not disadvantage the privatized enterprise relative to its competitors or result in extensive or unfair cross subsidization. A more transparent approach may be for the government to meet the cost gap associated with the provision of such services.

A “public equity issue” is another sale approach to transferring ownership and control of a public enterprise. The equity issue approach is commonly used with very large enterprises (such as telecommunications businesses) where it is unlikely that a single purchaser could raise the necessary capital.

Public equity issues are normally preceded by a valuation of the enterprise and the subsequent issue of a prospectus to the public which shows the same type of information revealed in the due diligence process. The main difference is that in a trade sale potential buyers engage merchant bank experts to assess the information. The prospectus distills and presents the same information in a way that is more easily digested by the large population of potential small investors, looking at issues such as net asset backing and earnings ratios for expected share prices.

An “equity issue” is a task of substance requiring experts to package, market and underwrite the issue. Indeed, whichever of the above sale approaches are adopted the government would be wise to engage legal and financial experts to ensure a smooth sale process.

Partial transfer of ownership and control

It is also possible for a partial sale to be undertaken of, say, 30% of equity in an enterprise. Using this approach the government can retain control of the business while reaping the benefits of sale proceeds. A partial sale can, however, give rise to conflict as the government tries to satisfy the commercial expectations of shareholders while at the same time honouring its own infrastructure policy commitments to the general public.

An example of the above is provided by the French Governments partial privatization of Air France announced in early 1998. The partial privatization will see 40% of the company sold off, with 17% going to the public and 3% to employees. In an innovative move a further 10% will be offered to pilots and managers in exchange for wage concessions as part of a move to lower costs.

One of the objectives of the sale is to make it easier for Air France to enter alliances with other international carriers².

The franchise/tender approach

A privatization approach which can have useful application, particularly in thin trades where a sale could give rise to a monopoly, is to franchise or tender out the management and operation of the enterprise for a fixed period, with the government retaining ownership of the business. This approach relies on generating competitive pressure through the tender process. The approach can even work on inherently loss making routes where community service obligations are involved by minimizing the government contribution to the revenue/cost gap arising from providing the services.

Foreign ownership and/or control

An important issue which needs to be considered as part of any privatization process is the extent to which foreign ownership and/or control will be contemplated. If, for example, for strategic reasons the government decides to limit the extent of foreign ownership and/or control there would be a direct impact on the sale process.

In the case of a trade sale foreign participation limitations may restrict the number of potential buyers. Under these circumstances the success of the sale will depend on how many domestic private businesses there are with the financial and operational capability to acquire and run the privatized enterprise.

In the case of an equity issue a major concern may be the extent of development of the local capital market and its ability and willingness to invest in the privatized business.

It should be noted that a sale to a foreign purchaser may bring benefits in the form of business experience, skills and resources. Before discarding foreign participation the loss of ownership/control may need to be weighed against the benefits to the nation of increased efficiency in the business.

As noted above the privatization of the state owned Thai Maritime Navigation Co (TMN) could see the Chinese company COSCO become a significant equity holder in TMN. With the Thai government looking to an expansion of TMN and its merchant fleet generally, an alliance with a major shipping line can provide many benefits, including access to the partners

Reference: One fifth of Air France up for sale. *the Australian*, 25 February 1998.

international shipping and agency network and management and technical expertise. In these days of intense international shipping competition a small line often just does not have the critical mass to survive, let alone expand.

The regions experience in public sector participation in shipping

The region provides an interesting cross section of examples of public sector participation. The developed countries, with an inherent disadvantage in competitiveness are either not involved in public shipping services or are withdrawing from them. Some developing countries (e.g. the Philippines and Thailand) are withdrawing from public shipping in order to promote private sector participation and/or improve efficiency. In some countries the rate of economic and private sector development is such that the public sector must be involved to ensure the provision of essential services (Bangladesh, India and Pakistan). In some countries the publicly owned shipping enterprises are an integral part of the nations macro-economic strategy (China, Indonesia, and Malaysia).

Australia

The Australian Government announced in 1993 an intention to sell its 100% government owned shipping corporation, the Australian National Line, which participates in international liner trades and coastal bulk trades. The sale process has been delayed pending a restructuring of the company to improve its financial position and saleability. The Australian Government has recently announced an allocation of budget funds to reduce the lines debt to assist in the sale process.

Bangladesh

Bangladesh has a 100% government owned shipping corporation, the Bangladesh Shipping Corporation. There appear to be no intentions at this stage to privatize this corporation. The Government is considering measures to increase private sector participation in shipping.

China

China has a number of state owned shipping enterprises which operate in international and domestic markets. These companies are subject to Chinese maritime law and regulation just like private shipping companies and are expected to compete in shipping markets on their own merits without assistance or preference from the Government of China. COSCO, a wholly owned

subsidiary of the Ministry of Communications, is one of worlds largest shipping companies with over 600 vessels.

India

The Government of India is extensively involved in shipping through its 80% ownership of the Shipping Corporation of India Ltd. (SCI).

SCI is the largest shipping company in India and, with 117 vessels aggregating about 3 million gross registered tonnes, accounts for over 45% of total Indian tonnage.

SCI will benefit from recent liberalization initiatives directed towards Indian Public Sector Industries which will allow SCI more powers in decision making in respect of capital investment, forming joint ventures and setting up offices abroad.

Indonesia

The Government of Indonesia has a 100% government owned shipping corporation. The Government has exempted the corporation from some taxes in order to assist its competitiveness.

Islamic Republic of Iran

There are a number of government owned shipping companies in Iran, e.g. I.R.I Shipping Line, Boscow Shipping Co. and Iran-O Hind Shipping Co. The Iranian Government is looking to increase the involvement of the private sector in the provision of shipping services given a perceived reduction in the need for a government presence.

Japan

The Japanese Government is not involved in the provision of shipping services.

Republic of Korea

The Government of the Republic of Korea is not involved in the provision of shipping services.

Malaysia

Malaysia has two national lines Malaysian International Shipping Corporation (MISC) and Perbadanan Nasional Shipping Lines (PNSL).

MISC was listed on the Kuala Lumpur Stock Exchange in March 1997. The Malaysian Government is effectively the majority shareholder in MISC holding 58% of the equity - 29% being owned by Petronas (Malaysia's national oil company), 9% by the Employees Provident fund, and the remaining 20% by the state government and government agencies.

PNSL is majority private sector owned. Konsortium Perkapalan acquired a 100% of PNSL in 1995 following an equity purchase from Pemas, a government trading corporation. Konsortium Perkapalan is 88% private sector owned.

Myanmar

The Myanmar government is directly involved in the provision of shipping services through its 100% owned Myanmar Five Star Line (MFSL). MFSL operates international shipping (both conventional and container) and coastal shipping.

New Zealand

Effective government involvement in shipping as an economic and trade policy adjunct ceased with the sale of the loss making New Zealand Shipping corporation in 1990. Current involvement is restricted to a 24% equity holding in a shipping company owned by South Pacific governments.

Pakistan

In 1974 all private shipping companies in Pakistan were nationalized as a matter of government policy. In 1993 the Pakistan Government took moves to encourage the private sector to acquire ships and compete in the open market with the national line, the Pakistan National Shipping Corporation, on the basis that full public participation was no longer required.

Philippines

The Government of the Philippines until recently owned two shipping companies, one providing liner services to the United States and the other

providing coastal oil tanker services. These companies are either in the process of being, or have been, privatized.

Sri Lanka

Sri Lanka has a fully owned shipping corporation entitled the Ceylon Shipping Corporation (CSC) which was established during the 1970s. As a relatively small corporation CSC experienced difficulty competing in the strong markets of the late 1980s and later years and its financial position eroded significantly. The aims of the Sri Lankan shipping policy covers measures to develop its national fleet, including revitalizing CSC. Policies relating to CSC are being reviewed by the government in light of its current trading position.

Thailand

The Thailand Government participates in shipping through the Thai Maritime Navigation Co. (TMN), a wholly owned non-vessel owning common carrier which benefits from access to government cargoes. TMN is to be privatized with minority equity to be held by the state.

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CHAPTER 9: ENSURE COMPETITIVE SHIPPING SERVICES FOR COUNTRIES FOREIGN TRADE

Shipping is a service industry that facilitates trade. Access to competitive, reliable and efficient shipping services has been identified by countries in the ESCAP region as a major policy objective in enhancing intra and inter-regional trade. Exporters and importers to day want their goods at the right place at the right time at the right price.

Shipping lines around the world seek increased efficiencies through economies of scale and shippers in the ESCAP region have been enjoying a buyers market for a considerable time. It is not surprising therefore that quite apart from any external pressure to liberalize the market for shipping services, countries in the region feel it is in their interest to encourage overseas ship operators to carry the countries trade. Policy makers are aware that it would provide importers and exporters with competitive shipping services and lower freight costs

Factors that attract overseas shipping services

Overseas shipping lines, like all other business enterprises, finally look towards a return on their investment. They would be attracted to service a countries trade if the following factors are present.

- Adequate cargo volumes
- Non discriminatory regime
- Minimum bureaucracy
- Clear regulatory framework.

Adequate cargo volumes

Adequate cargo volumes are the biggest attraction to overseas shipping lines in serving a countries foreign trade. Increase in cargo volumes would depend in the first instance on the growth of trade in each country. The concept of the hub port and multimodal transport how ever has brought new opportunities to countries that are strategically located. Countries that can attract transshipment cargo would not only enjoy direct economic gains through the provision of increased port services and other maritime related services, the trade would also benefit from competitive freight rates that could be offered by main line and feeder

vessels calling at the countries ports to carry transshipment cargo. For these lines the carriage of the countries overseas trade would be in fact the icing on the cake. In spite of the economic turmoil brought about by the financial crisis of East Asia, the ESCAP region is held out to be one of the leading growth areas of the world.

Development strategies have to be based on information. Multinational companies usually have entire departments that specialize in research and provide information to senior management. Public sector organizations and government ministries have to develop a culture that seeks information and statistics. Trade and transport projections prepared by private companies come at a price and may not be affordable for the maritime administrations of many of the countries in the ESCAP region. These countries could benefit from the information contained in the trade and development reports that are published by international organizations such as UNCTAD, ESCAP and the world Bank. The Internet is also a very valuable source of information.

Non discriminatory regime

The specific objective of encouraging overseas shipowners to carry the countries overseas trade and the objective of developing national fleet(s) have to be held in balance in order to ensure their compatibility. Any support measures afforded to the national shipping fleet(s) should thus be directed at making these fleets internationally competitive and should not be discriminatory towards overseas ship owners. It is clear from the discussion in Chapter 5 that the majority of countries in the ESCAP region have to a large extent voluntarily abandoned cargo reservation schemes and are conscious of the need to do away with remaining bi lateral cargo sharing provisions.

Countries in the ESCAP region are however keen to explore fiscal measures that would not be discriminatory to overseas shipping, but can provide national lines with the support required to survive and grow in this intensely competitive shipping market. Countries in the region are also keen to facilitate ship financing schemes that would enable their ship owners to replace old tonnage and invest in modern technology.

In the final analysis, policy makers have to understand that support measures afforded to national ship owners have a direct and indirect cost which can be measured in tangible terms. It is also necessary to bear in mind that the resumption of WTO negotiations on maritime services in the year 2000 would require progressive liberalization of shipping services. The picture that emerges from the questionnaires, country reports and country visits is that shipping is already a very liberalized services sector compared to other transport and service sectors.

Certain indirect constraints may yet hamper the provision of shipping services by overseas shipping lines. These relate to restricted/regulated access to port and port services, restriction on the selection of shipping agents, restrictions on establishment of branch offices to service ships calling at the port, restrictions on establishing agency businesses, differential tariff structure in ports, high bonds and guarantees required by Port Authorities.

Minimum bureaucracy

Cumbersome procedure and bureaucracy would discourage overseas shipping lines from servicing a countries foreign trade. The bureaucracy may relate to licensing arrangements for ship owners, filing of tariffs and information pertaining to the goods or procedure and billing processes of the ports. Any measures that may delay a vessel in port would discourage ship owners form calling at a particular port to the detriment of the trade.

Bureaucratic procedures are often a legacy from a closed economy and resulting governmental control and cannot be dismantled overnight. Removal of outdated procedure often requires an attitudinal change amongst those responsible for the national maritime administration. This comes with exposure to more efficient methods of doing business, education and time. It is important that policy makers are aware of the need to simplify rules and procedures in order to attract overseas service providers and investors in maritime transport business.

Clear regulatory framework

Liberalization of shipping services brings in its wake, a number of important issues relating to the regulatory framework that have to be addressed by policy makers.

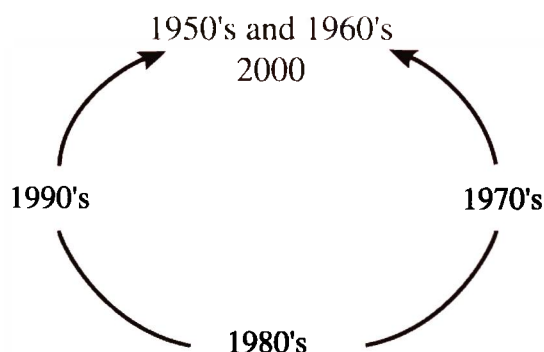
Scope and extent of liberalization

The scale of liberalization, the timing and sequencing have to be determined taking into account the developments that have taken place in the shipping sector up to the present time.

The evolution of shipping services in the ESCAP region fall into several distinct stages and appears to have gone a full cycle during the last 50 years.

<u>1950's & 1960's</u>	<u>1970's</u>
<p>Status: Shipping services dominated by overseas shipping lines</p> <p>Market access: controlled by liner shipping conference practices and absence of national shipping fleet(s).</p> <p>Controlled environment.</p>	<p>Status: Shipping services provided by national fleet(s) and overseas shipping lines</p> <p>Market access: controlled by governments through national legislation.</p> <p>Protectionist environment.</p>
<u>1980's</u>	<u>1990's</u>
<p>Status: Shipping services provided by overseas shipping lines and national shipping fleet(s).</p> <p>Market access: liberalized through partial removal of protectionist measures and weakening of liner conferences.</p> <p>Move towards further liberalization</p>	<p>Status: Shipping services predominantly provided by overseas shipping lines with some participation of national fleet(s).</p> <p>Market access: further liberalized. Liberalized and competitive environment brought by market forces.</p> <p>Further liberalization</p>

<u>2000</u>
<p>Status: Shipping services in some sectors dominated by a few major shipping lines through merges and alliances</p> <p>Market access: Complete liberalization and application of market forces.</p> <p>Control environment as a result of market forces</p>



As the countries in the ESCAP region move towards the 21st century, there is renewed commitment to the liberalization of shipping services. What would be the result of such liberalization? Apart from the removal of all restrictions on access to cargo and the type of services offered by overseas shipping lines; would it also mean the absence of any government regulations?

Deregulation of an industry does not mean that there should be no regulations covering that sector. It means that there should be no “restrictive regulations” that curtail market access. Self regulation through industry organizations should also be encouraged. Regulations should thus aim at the following:

Allow access on equal terms to all participants and potential entrants.

- Existence and safeguard of a fair and competitive market.

Access on equal terms to all participants

Apart from the removal of any direct measures related to unilateral or bilateral cargo reservation, access on equal terms would involve the removal of indirect restrictive measures such as differential pricing on navigation and port charges to overseas vessels.

Developing countries in the ESCAP region have to be also aware of the challenges that would be posed in the negotiations on maritime services that would be initiated by WTO in year 2000. The WTO General Agreement on Trade in services (GATS) provide that there should be no discrimination in favour of national providers - national treatment principle¹; and that there should be no discrimination between other members of the agreement - Most Favoured Nation principle (MFN)². GATS also provide important exceptions. Firstly governments can choose the services in which they make market access and national treatment commitments. Secondly they can limit the degree of market access national treatment they provide, and third, they can take exception from MFN obligations,

The principle is explained in Chapter 2.

This principle is explained in Chapter 2.

in principle for ten years, in order to give more favourable treatment to some countries than to WTO members in general.³

Policy makers thus have to identify the barriers to the export (or potential) exports of services currently applicable and further commitments that the country could offer in market access and national treatment.⁴

Multilateral negotiations under WTO will be a continuing series of tradeoffs and the policy makers have to fully understand the system of rights and obligations, commitments and exceptions in order to benefit from the new regime. The forthcoming negotiations on maritime services would bring to focus some of the sub sectors where there is scope for further liberalization, such as shipping agency services, and other maritime related services such as bunkering, surveying, marine insurance, navigational and port services.

India had participated in the WTO Negotiating Group on Maritime Transport (NGMTS), until the negotiations were suspended in 1996. The offer tabled by India provides a good illustration of the practical application of the GATS system and is contained in Annex 3.⁵

Existence and safeguard of a fair and competitive market

Liberalization of shipping services and the intense competition amongst shipping lines have resulted in importers and exporters enjoying unprecedented low freight rates for much of this decade. This has resulted in the trade lobbying for a non-interventionist approach from maritime administrators, and shippers' associations losing some of its momentum.

Market forces alone, however, cannot ensure the long-term stability of freight rates or the scope of shipping services required by exporters who seek new markets. A clear regulatory regime is required to avoid unfair and restrictive practices in the provision of shipping services. The concentration of market power and the recent upward trends of freight rates on some routes have alerted the trade to the need for a set of competition rules and the need for some monitoring of the behaviour of national and overseas service providers. With the reduction of barriers to competitive shipping services initially put up by governments, through

<http://www.wto.org/wto/services/services.htm>

⁴ The National Treatment Standard is one of the main standards that is used in international practice to secure a certain level of treatment for Foreign Direct Investment (FDI) in host countries.

Source: country report prepared for ESCAP under the Shipping Policy project.

progressive liberalization, it is important to guard against barriers that could be put up by the private sector in reducing competition. The continuing battle between major shipping lines to achieve economies of scale through larger vessels and mergers and alliances could bring about the oligopolistic market structure that prevailed in the 1950's and 1960's during the reign of the liner shipping conferences.

In this context, it is also important to examine whether any anti-competitive behaviour and abuse of market power by global alliances could be effectively dealt with by the antitrust or competition policy of a national maritime administration.

The prospect of including the subject of competition in the multilateral trading system of the WTO has been discussed in several forums, and two schools of thoughts have emerged.

- Competition comes within the purview of domestic policy and should be dealt with by national governments and not multilateral organization. Cross-border disputes could be dealt with bilaterally, or under bilateral cooperation agreements.

Examples of bilateral agreements would be those concluded by the United States and the EU and the United States and Canada and the voluntary bilateral cooperative action of the OECD countries.⁶

Bilateral cooperation agreements could be widened by including common rules in regional trade agreements, as done by the EU through its common competition policy.

A multilateral agreement on minimum competition standards should be negotiated

In the case of WTO systems, this could be achieved by strengthening GATS article IX or by including competition rules in each sectoral annexes of GATS

See UNCTAD, world investment Report 1997. Transnational corporations, market structure and competition policy. New York, Geneva, 1997. Part two WTO, Annual Report 1997, Geneva 1997, Chapter four.

The legal framework for a set of competition rules could in this event be considered during the fourth coming GATS negotiation on Maritime Services.⁷

Competition policy is a complex subject and the question whether such policy should be included in the WTO framework on competition and subject to the WTO dispute settlement system should be carefully considered by policy makers in the ESCAP region.

Before taking up the question of competition rules at an international level, policy makers would gain from the study of the general competition policy or rules that may prevail at a national level. The regulatory regimes of the United States and Australia have been subject to extensive discussion within the shipping industry in each country and are enumerated below as interesting regulatory models.

Regulatory framework - USA

As stated in chapter 2, The United States policy of ensuring free trade and fair competition in all industries is implemented through the anti-trust legislation contained in the Sherman Act of 1890 and related legislation. According to the Act, practices restricting free competition in the market are illegal and monopolizing of trade is prohibited.

Liner conferences by their very nature contravened such legislation and required anti-trust immunity in order to survive. In the U.S. this was granted through a series of legislation, including the latest Ocean Shipping Reform Act of 1998 (OSRA). The Act provides anti-trust immunity to ocean carrier agreements filed with the Federal Maritime Commission (FMC) or agreements that are exempted from filing with FMC. It prohibits certain acts of carriers and requires that carriers must provide service in accordance with rates and terms of tariffs or service contracts.

Container shipping lines will thus be in a position to sign individual confidential contracts for the first time with exporters and importers. This is expected to loosen the grip of liner shipping conferences that have legally set rates for ocean shipping in the United States for over a century.

Preparing for future multilateral trade negotiations: issues and research needs from a development perspective, United Nations, New York and Geneva 1999 (UNCTAD/ITCD/TSB/6).

The Act provides that the service contracts have to be in writing and can be between one or more shippers and an individual ocean carrier or group of carriers, pursuant to an agreement.

The service contracts must contain a number of essential terms. The published terms must include the port ranges, commodity, minimum volume/or portion and duration of contract. Other essential terms such as the rate service commitments, inland origin/destination and liquidated damages can remain confidential between the parties.

According to the prior law, (1984 US Shipping Act) the conferences could regulate or prohibit individual carrier contracts. Under OSRA, liner conferences cannot prohibit individual contracting.

According to the prior law, carriers had to ensure that essential terms were made available to similarly situated shippers. No further “Me too” rights are available to shippers under OSRA. OSRA provides that remedies for breach of contract is to be sought in the courts of law. Parties could also agree to other remedies.

The Federal Maritime Commission continues to play a major role in the regulatory process governing ocean shipping services in the United States and OSRA has to be read in the light of the Federal Maritime Commissions implementation Rules. The FMC would monitor and regulate foreign practices which affect United States shipping or US carriers. It has the power to take action to correct and counter balance adverse, unfair or unfavourable foreign practices. The success of the FMC in the next decade depends on its ability to carry out these functions in keeping with the spirit of minimum governmental intervention and greater reliance on the market place which are declared policy objectives of OSRA.

Regulatory framework - Australia

Australia’s policy to preserve competition in all Australian trade and commerce is implemented through the Trade Practices Act 1965.

The Trade Practices Act 1965 contains the following fundamental principles:

- Prohibits contracts, arrangements and understandings restricting or substantially lessening competition.

-
- Prohibits the misuse of market power.
 - Prohibits exclusive dealings between suppliers and users.

Liner shipping conferences as could be expected infringed these principles, and over the years several acts have first totally exempted and then partially exempted the application of the Trade Practices Act to overseas cargo shipping and liner conferences.

Although a separate Act covering the shipping sector, as in the United States has been proposed and discussed in Australia several times, successive governments have preferred to include a section covering shipping services in the Trade Practices Act itself.

Part 10 of the Trade Practices Act initially exempted liner conferences from the application of the prohibitions against restrictive trade practices contained in sections 45, 46 and 47 of the Trade Practices Act. The subsequent amendment to the Trade Practices Act, Trade Practices (liner cargo shipping) Amendment Act 1989, lifted the total exemption and replaced it with a partial exemption.

The last review of the Trade Practices Act in 1993 suggested that parties to commercial transactions should be encouraged to reach commercial solutions and government should only intervene where economic power is concentrated on one side of a market and open to abuse, or parties cannot reach agreement or rules are breached. The recommendation was “Regulation with a light hand”.

CHAPTER 10: THE PROCESS OF FORMULATING AND IMPLEMENTING SHIPPING POLICY

Well developed shipping policies reflect the circumstances under which they were made. These include the prevailing financial and economic situation, both within and outside the country, and the trading and industrialization strategy of the country concerned. The shipping policies must have achievable goals that can be translated into operational measures for policy implementation. The process of shipping policy formulation must also provide policy makers the opportunity to examine options and available alternatives so that shipping policies when formulated and implemented will truly complement the country's economic development strategy.

Process of policy formulation

The development of national economic policy is the prerogative of government. The government would wish to ensure that the policies formulated by various sectors/ministries would jointly achieve overall national economic policy objectives.

In an ideal scenario, national economic policy would provide a consolidated view of the nations economic objectives and indicate how they are to be achieved. Each sector of the economy would draw up a master plan clearly indicating the contributions it would make towards the overall economy and the policies/strategies to achieve this end. The reality however is often quite different. Some industry sectors may draw up comprehensive plans which spell out policies and strategies. Other sectors may formulate policies which are either statements of intent (mother hood statements) or policies that are merely wish lists. Some sectors would engage in the adoption of ad hoc policies directed at particular aspects of the industry.

The successful process of policy formulation requires that the policies developed by a particular Ministry is accepted by other Ministries, by the Cabinet of Ministers, and eventually by the public sector and private sector of the concerned industry. Compatibility with national economic plans, budgetary questions, territorial issues with other ministries, all have to be resolved, by policy makers and senior government officials with persistence and patience.

Participatory as against a unilateral approach

Developing countries in the region have traditionally considered the formulation of shipping policies to be the sole responsibility of the minister in charge of shipping. A unilateral approach where the Minister and the Maritime Administration determines policy has a distinct advantage in terms of time. A unilateral approach however does not allow much consultation with industry. As a result, policy makers may not have the benefit of a full understanding of all the issues involved and may not utilize the expertise available in the industry. Lack of adequate consultation may also lead to misunderstanding of the policy objectives and result in resentment of the industry and lack of cooperation in implementation of the policy.

Developed maritime countries have adopted a more participatory process with extensive consultation with the shipping industry. The specific process followed would differ from country to country but the maritime administration would usually appoint a committee¹ to look into the issues and make recommendations to the government. The committee would have specific terms of reference and a time frame. The findings and recommendations of the committee would be given publicity and submissions requested from the shipping industry, academic and research institutions, and the wider public. All submissions would be given due consideration in developing policies and strategies.

Developing countries in the region are increasingly recognizing the need for a participatory approach to policy formulation. It is important however for policy makers to ensure that the participatory approach does not hamper and delay the process of policy development. Disagreement between industry players and vested interests could result in a lack of consensus and stalling of the process of policy formulation. A participatory approach does not mean that the policies are developed by the industry. The extent of participation by the industry would depend on the rapport between the Ministry/Department in charge of shipping and the industry, the maturity of the industry and the expertise available within it. The industry in this regard would include the public and private sector stakeholders who have an interest in shipping. With the advent of liberalization and the reduced role of the public sector in shipping business, the input of the private sector shipping industry is necessary to develop sound strategies that would achieve policy objectives. In the final analysis however it is the Ministry in charge of shipping that formulates the policies, and takes responsibility for the policy/ measures.

Such committees are given different titles such as a Select Committee, Ministerial Committee or a Task Force

in charge of shipping that formulates the policies, and takes responsibility for the policy/ measures.

Figure 10.2 identifies the primary and secondary stakeholders in the shipping sector. It also clearly indicates the increased private sector participation within the stakeholder community.

Table 10.2: Stakeholders in the shipping policy process

STAKEHOLDERS
Government
Exporters and importers
Shipowners and operators
Ship Agents
Ports
Seafarers
Road Hauliers and Railway
Freight forwarders and multi modal transport operators
Inland container depot operators
Ship repairers and shipyards
Ship chandlers:
Salvors
Other providers of ancillary maritime services
Workers in the above businesses
Customs
Board of investment or other regulatory organizations
Professional Associations dealing with shipping (CIT, CIS, Shipbrokers)
Academic/Research Institutes dealing with maritime studies
Public at large

The following case study elaborates regional experience in shipping policy formulation.

Case Study - SRI LANKA

One of the successful efforts at policy formulation in this region in recent years has been that of Sri Lanka which adopted a participatory approach to develop a comprehensive shipping and port policy for the country. The industry task force appointed by the Minister in charge of shipping and ports consisted of representatives from all stake holder groups including the public and private sector and senior representatives from the Ministry of Shipping and Ports. This has ensured a continuing dialogue throughout the process between industry and Government, resulting in the specific recommendations contained in the final report of the Task Force being acceptable to the Ministry of Shipping with little modification. Even so the process of moving the policy through the cabinet appears to have taken longer than originally anticipated. Taking into account the changing shipping scenario, the Task Force has also been given the opportunity to review the main proposals again and ensure consensus before the policy was presented a final time to cabinet.

Composition of the Industry Task Force:

Director Merchant Shipping
Principal Collector of Customs
Consultant, Ministry of Shipping and Ports
Chairman, Sri Lanka Ports Authority
Chairman, Ceylon Shipping Corporation
Chairman, Central Freight Bureau of Sri Lanka
Chairman, Port Services Ltd.
Chairman, Ceylon Association of Shipping Agents (CASA)
Chairman, Sri Lanka Shippers' Council
Secretary, Ceylon Chamber of Commerce
Chairman, Sri Lanka Freight Forwarders Association
Representative, Chartered Institute of Transport
Representative, Chartered Institute of Shipbrokers
Special Adviser to the Minister of Shipping and Ports

The steps in the process followed by Sri Lanka:

December 1994:

- Major Forum organized by Ministry of Shipping and Ports "Towards a Comprehensive Shipping Policy for Sri Lanka". Fourteen papers presented by representatives of public sector and private sector stakeholders on current position in each area and projections for the future.

January 1995 - August 1995:

- Industry Task Force (ITF) formed, scope of shipping policies agreed and a vision for the maritime sector developed through team work. Macro and micro economic objectives in each of the sub-sectors falling within the scope of the comprehensive shipping policy identified.
- Extensive formal and informal discussions held between the members of the ITF and key public sector and private sector industry figures. The discussions were directed at ascertaining the constraints and strengths of the different sub-sectors, the potential and possible strategies for the future.
- Extensive briefing sessions were also conducted between the ITF and the Minister of shipping and ports and the Secretary to the ministry.

August 1995:

- The preliminary report of the ITF handed over to the minister of shipping and ports.
- Preliminary report made available to the wider shipping community through the trade organizations which had representation in the ITF and feed back requested.
- Preliminary report forwarded to other relevant Ministries and their views requested

September 1995:

- ITF discussions with industry entities that provided feed back.

October 1995:

- ITF handed over final report to Minister of shipping
- Ministry of shipping prepared shipping policy document based on the ITF report, incorporating the observations of other Ministries.

December 1995:

- Ministry of shipping and ports finalized the ports and shipping policy.

January 1996:

- Ministry of shipping and ports submitted shipping and ports policy to the Cabinet of Ministers.

January 1996 - to October 1996:

- Shipping and ports policy subject to discussion and policy document referred to a ministerial subcommittee for review. Long process with the policy being further referred to National Development Council for comments.

October 1996:

- Views of the National Development Council and all other views referred to a meeting between the ITF and the Minister for Shipping and Ports

November 1996 - April 1997:

- Shipping and Ports policy considered again by the cabinet of Ministers and approved.

May 1997:

- National and Ports policy declared by the Minister in charge of shipping and released for circulation.

The Sri Lankan experience demonstrates that the process of policy formulation can be long drawn out. The success of a participatory approach requires a good support between the maritime administration and the wider shipping industry. It also requires a focal point at the highest levels of government. It is clear from the Sri Lankan experience that the close working relationship between the Ministry of Shipping and Ports and the ITF would have helped to achieve a high level of consensus between all the parties on a range of diverse issues. The importance of the focal point is also demonstrated in three other countries where ESCAP has conducted country-level workshops on the development of national shipping policies. Thailand, Bangladesh and Pakistan have embarked on programmes of policy development covering all aspects of shipping and ports.

The Secretary-General, Overseas Promotion Commission (OMPC) in Thailand, the Secretary, Ministry of Shipping, Bangladesh, and the Director General of Shipping and Ports, Pakistan, act as focal points and have been able to sustain the process of participatory policy planning over a long period of time. All three countries follow the model of Sri Lanka with some variation and on successful completion would provide good models for other countries in the ESCAP region.

Implementation of shipping policies

The shipping policies of a country may document the overall objectives and the specific objectives designed to develop the maritime sector. These objectives may be referred to as macro economic policies and micro economic policies. The shipping policies may further elaborate the strategies through which the policy objectives are to be achieved.

These policies and strategies may be implemented through national legislation, administrative measures and through further development and implementation of specific business plans.

Take for example the policy objective of developing national shipping fleet(s) discussed in Chapter 5. This would be a macro economic objective². The Government may further determine that national shipping fleet(s) should be afforded fiscal support to acquire new tonnage. This would be a micro economic objective. In order to achieve this objective the government may decide on a strategy of affording shipowners a package of fiscal incentives. If this be the case

Terms not meant to be definitive but used to explain the process of policy formulation, development and implementation.

the specific fiscal incentives have to be examined, and agreed upon with the financial institutions and the Ministry or Department of Finance. In the event that the fiscal measures included the setting up of a fund, then the structure and management of the fund will also have to be developed. The establishment of a shipping development fund may require the enactment of specific legislation. Fiscal measures such as reduction of income tax would also require the agreement of the Ministry or Department of Finance and amendment to tax law/regulations.

In order to implement a regime of fiscal support, policy makers will also have to identify the shipowners who would be entitled to the fiscal benefits. This would require a review of the shipping registration regime applicable in the country. If financial institutions are to be encouraged to provide financing to shipowners, they would require a clear mortgage regime that would allow the arrest of the vessel that is financed, as well as surrogate vessels belonging to the same owner.

Implementation of a country's shipping policy including the monitoring, is normally carried out by the maritime administration, or a special governmental organization which is entrusted this function. The government may also appoint an advisory body drawn from the shipping industry to help with the further development of strategies and plans.

Inadequate institutional arrangements, bureaucratic overlaps and delay in the enactment of national legislation would reduce the effectiveness of policies and create frustration and disillusion amongst the stakeholders who have been involved in the process as well as the wider industry.

The Sri Lankan experience also suggests that the implementation of policy measures could have been more speedily accomplished, if further attention had been given to the implementation process and institutional capacity building at the time the policies were formulated. This issue is being carefully considered in the development of shipping policies in Thailand, Bangladesh and Pakistan.

Institutional and administrative framework

The organization(s) responsible for maritime administration must keep abreast of the national and international development in the shipping scene and be fully aware of the multilateral agreements (International Conventions) in force in the maritime sector. Such organizations must have access to maritime experts who can advise on further development of the policies and strategies operational plans. Implementation of policies also require the development of administrative

directives (circulars) and national legislation. The fragmentation of national organizations responsible for the administration of the maritime sector often results in such expertise being thinly spread among several organizations. This can in turn hinder the development and implementation of comprehensive shipping policies and the growth of the entire industry.

The following Table 10.1 is a typical structure of a traditional maritime administration.

Table 10.1: Typical structure of a traditional maritime administration

Ministry in charge of shipping and ports						
Main Business	Transport Administration		Maritime Safety			
Services	Planning for strategic development	Regulatory arrangements	Navigational services	Ship & personnel safety services	Maritime safety services	Marine environment protection services
Function and role	International & domestic shipping operators Programme of financial assistance for shipowners	Ratification of International Conventions	Navigational safety policy Navigation aids network	Survey and certification of ships Ship registration Safety standards Inspection of foreign ships Safe handling of seaborne cargo Maritime personnel training and planning Training and certification of seafarers	Coordination of marine search and rescue Operation of a maritime safety communications centre	Prevention of marine pollution Preparation and implementation of oil spill contingency plan

Comparison between a traditional and modern structure of a maritime Administration

Case Study: Australia - Maritime Administration
Pre 1990 structure

DEPARTMENT OF TRANSPORT

Maritime operations division

- Maritime safety
- Navigation aids
- Ship registration
- Search and rescue

Maritime Policy Division

- Shipping industry policy
- Waterfront industry policy
- International shipping policy

Post 1990 Structure

DEPARTMENT OF TRANSPORT

Maritime Division

- International and domestic shipping policy
- Shipping regulation
- GBE oversight
- Ports and services policy
- Maritime

Australian Maritime Safety Authority (AMSA)

- Navigational aids and services
- Ship and personnel safety services
- Maritime safety services including marine search and rescue
- Strategic development (planning, safety education and public relations)
- Ship registration and other commercial services

The (AMSA) is a statutory authority established under an act of parliament and is operated on commercial lines. It is governed by a board of directors and a chief executive officer and is responsible to the minister in charge of shipping. The revenue structure of AMSA (Table 10.2) provides an interesting model for countries in the region seeking to restructure their maritime administrations.

Table 10.2: The revenue structure of Australian Maritime Safety Authority (AMSA)

AMSA Finances 1996-97	
	(\$AUS million)
Revenue	
Marine navigation levy	33.04
Regulatory functions levy	13.55
Protection of the sea levy	3.39
CSO (Government funded)	8.8
Other revenue	9.78
Total Revenue	68.56
Total expenditure	63.9
Surplus (after abnormals)	2.28
Return on equity (before abnormals) amounted to 7.2%.	

Legislative framework

Shipping policies are often implemented through national legislation. This legislative task requires a combination of legal skills, a good appreciation of government shipping policy objectives and a sound knowledge of the subject matter in question.

One approach to the drafting of legislation would be for the ministry in charge of shipping to prepare an initial draft of the subject matter in consultation with the legal draftsman and any other related ministry, and then hand it over to the legal draftsman to develop the legislation further.

Another approach is to form a small team made up of representatives from the ministry of shipping, any other related ministry and the legal draftsman's department to prepare an initial draft. This can then be developed further by the legal draftsman in consultation with the ministry of shipping. The approach adopted would vary from country to country, but policy makers must bear in mind the fact that the process of enacting legislation can be as long and as time consuming as the process of policy formulation.

A sound legal framework and a credible and independent enforcement machinery including the judiciary, will help to build investor confidence.

Policies relating to some aspects of shipping such as the cargo liability regimes, maritime safety and the protection of the marine environment are usually developed in accordance with international shipping policy and international law formulated by the international community through international organizations such as the International Maritime Organization (IMO) and the United Nations Conference on Trade and Development (UNCTAD), and the International Labour Organization (ILO).

These multilateral treaties, known as International Conventions are agreements adopted by a large number of sovereign states. Once an international convention is finalized, participating states may adopt the convention unanimously. If there is no unanimity, the convention is put to vote. Some states vote in favour, some states would vote against and some states would abstain from voting. If the convention is adopted by a majority of votes, then the convention will be open for signature to all states.

An international convention does not immediately come into force on adoption, even with regard to the states that sign the convention. Each convention has a special provision to indicate when the convention will come into force. The requirement may be that a certain number of states must agree to adhere to the provisions of the convention by ratifying or acceding to the convention. Or that ratifying or acceding states account for a certain amount of tonnage.

Once a country ratifies a convention and the convention comes into force, the country has an international obligation to implement the convention. Such implementation is usually achieved through suitable national legislation. Once such legislation is enacted, the provisions of the international convention filters through to the industry.

Table 10.3 Links between international policy, international law, national policy and national law



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ANNEXURE I
THE CABOTAGE DEBATE

THE CABOTAGE DEBATE

National economy arguments

The main case made by proponents of cabotage relaxation refers to economic benefits arising from access to lower freight rates. For example, a 1991 report of the U.S. International Trade Commission estimated that the Jones Act resulted in a welfare cost to consumers of between US\$4.2 and US\$10.4 billion annually in 1988 dollars.

Particular economic benefits typically cited under this argument are:

Lower costs of production and delivery leading to lower prices for consumers and increased trade competitiveness

Coastal shipping provides input to the national economy either through the transport of commodities used in manufacturing (as an intermediate cost of production) or through the distribution of finished goods (as a component of final retail prices).

Policy makers need to make an objective assessment of the overall economic benefits of the removal of cabotage. This will vary from country to country depending on its industrial profile and the competitiveness of its shipping industry.

Many national statistical authorities produce tables called input-output tables which detail the linkages and interdependencies of industries and their output, including transport. If these tables are available they can provide a useful tool for the policy maker.

Generally it will be found that shipment costs will be a higher proportion of the price of low value commodities (bulk goods, rural produce, etc.) than high value finished goods such as manufactures

The USA Maritime Cabotage Task Force, defending cabotage, claims that a 50% decrease in shipping freight rates for unleaded gasoline would have an impact of only one cent per gallon at the pump, or around US\$7 per year for the average US car driver.

Elimination of import substitution

High coastal shipping costs can lead to domestically produced goods being uncompetitive with imports when domestic distribution costs substantially exceed international shipping costs.

This situation can arise particularly in relation to thin domestic trades and low cost commodities or when the international shipping has a cross trade or marginally costing advantage.

Examples cited by the Jones Act Reform Coalition include that it is cheaper to import coal from Indonesia to the USA than ship it from Alaska.

It should be noted that under some circumstances domestic shipping will always find it difficult to be cost competitive. There is a large fleet of foreign bulk ships continually servicing Australia's substantial exports of coal, iron ore, wheat, sugar and alumina. As most of these ships arrive in Australia empty there is an opportunity for them to marginally cost their inbound capacity at rates that domestic shipping could never compete with.

Competition arguments

A reason often cited for relaxing cabotage is to introduce competitive pressures into domestic shipping markets with resultant freight and efficiency dividends. While the economic logic of this argument is attractive, actual benefits will depend on the size and structure of the coastal shipping market concerned. Policy makers should also be conscious of the possible impact of the increased competition on the long term supply of domestic transport services.

The competition argument would appear most relevant to general (multiple) user shipping such as coastal liner shipping or coastal tramp shipping.

International cross trading ships in particular may be able to offer marginally costed freight rates which not only significantly undercut rates offered by domestic shipping, but indeed also undercut alternate domestic transport modes such as road or rail.

While these lower freight rates and the competitive pressure they create may look very attractive to shippers initially, there is a need to look beyond the immediate windfall gain.

There is a possibility the cross trader may not always be able to meet the needs of the shipper. Two questions the shipper and policy maker need to ask are:

- *What assurance is there that the cross trader will maintain the services?*
Pressures on international shipping are such that routes are selected and maintained on the basis of optimizing cargoes and returns. A downturn in another part of the world could see a route or frequency re-adjustment to the detriment of the coastal shipper.

- *Will the cross trader always be able to provide the cargo capacity the coastal trades require?* Many international liner trades are seasonal in nature. The cross trader can only offer marginally costed rates if he has space available. There is a possibility that at certain times of the year no space is available.

The answers to these questions are especially relevant if the coastal shipping trades which the cross traders enter are thin (i.e. low volume) cargo trades. It is possible that the rates offered by the cross trader are such that the domestic transport industries cannot compete no matter how efficient they are. Introducing competition in this form could actually threaten the viability of domestic transport industries who could argue that it is unfair to expect them to compete with foreign transport businesses whose services are not being costed in such a way as to reflect the true costs of providing those services.

Policy makers contemplating allowing cross trader entry to coastal trades should carefully examine the vulnerability of domestic transport industries to cross trading competition and the availability of contingency or fall back transport if the cross trader cannot meet demand.

Shipper controlled shipping

Shipping which operates in vertically integrated industries¹ is often shipper controlled. These trades typically feature single commodity cargoes such as crude oil or petroleum product (tanker trades) and coal or iron ore (dry bulk trades). The trades are usually part of a supply chain or distribution network where regularity and reliability are critical, especially when providing input into tertiary industry establishments such as steel production.

The consequences of these cargoes not arriving on schedule can be substantial, such as necessitating the closing down of a blast furnace or a refinery. A shipper may be prepared to pay a premium for reliability and efficiency in his shipping to avoid such consequences.

It is unlikely that the ship type and size requirements of the above shippers, as well as supply reliability, could be met from the vagaries of the international cross trading fleet. If these shippers are to benefit from a relaxation of cabotage it is likely to be only through the long term presence of a dedicated appropriate foreign fleet. However it is possible that competitive pressure may be obtainable through a ship management tender process.

¹Vertically integrated industries are those where a single economic enterprise typically controls both material input and production industries. For example a steel maker may also own/control coal and iron ore mining interests.

The concept of tendering for transport services over fixed periods as a means of putting competitive pressure on costs is not new and is often used in markets where the scope for multiple competitors is limited. The extent to which it would be successful in coastal shipping under a cabotage regime would be dependant on the level of competition within the ship management industry.

Guest labour arguments

Two arguments often raised in defence of cabotage are that:

the abolition of cabotage will result in job losses amongst ship crews; and

why should coastal shipping be expected to face competition from foreign labour when no other domestic service industries are subjected to such pressures.

In relation to the first argument consideration needs to be given to the impact of cabotage abolition policies on overall employment in the economy, not just employment in the shipping industry. The abolition of cabotage may result in employment creation in other industries which outweigh shipping industry job losses.

In relation to the second argument it is true that jobs in many domestic service industries such as truck and bus drivers, and hotel and catering staff may normally be reserved for nationals. It is also probably true that substitution of that domestic labour with lower priced foreign labour might reduce those service costs to the national benefit, and indeed this does happen in many developing countries which participate actively in an extensive international market in labour.

Domestic transport costs have an input into the final cost of production and to that extent are a component of trade competitiveness. In the tourism industries prospective destinations must compete on price as well as on natural or other attractions. Why therefore is there a focus only on coastal shipping services?

The answer is probably not entirely logical but arises from a number of factors, some possibly psychological in nature. Shipping is a capital intensive industry requiring substantial investment. This can be an impediment to the development of competition, especially in thin coastal trades. While coastal shipping is clearly a domestic task it takes place in international waters side by side with internationally trading shipping, so that the opportunity for competition is more evident. Additionally while foreign workers might be taking the place of domestic workers if cabotage is removed, they might never set foot on land. To the extent that the foreign workers do not cross immigration and customs barriers there is a reduced perception of them as part of the domestic labour force.

Strategic fleet arguments

The strategic value of the national coasting fleet is sometimes raised in defence of cabotage. It can be expected that the potential utility of the fleet for military or civil defence purposes will be directly related to the suitability of fleet for the purposes contemplated and the locations at which the fleet might be used.

For example, roll-on/roll off ships are often highly regarded for strategic purposes because they are not dependent on shore based stevedoring facilities and can offer flexibility in terms of the types of cargoes that can be carried (including vehicular cargoes).

Ultimately it is unlikely that cabotage policy would be driven by such strategic motivations particularly if it leads to a compromise of the efficiency of the coasting fleet. This would not, however, preclude a fleet being utilized for strategic purposes once a policy on cabotage was established.

It is worth noting that the cargo fleet supporting the United Kingdom in the Falklands conflict was chartered for the purpose.

Current account arguments

Another defence often raised for cabotage is that there will be a negative balance of payments outcome from substituting a foreign owned fleet for a domestically owned fleet.

This argument typically cites that while the freight payments for carriage of coastal cargoes are being paid to domestic shipowners there is no impact on the nations international accounts. However, if cabotage is removed those freight payments are made to foreign shipowners and there is a resultant outflow of funds which has a negative impact on the current account of the balance of payments. A useful analogy to this is the consuming imported goods rather than locally produced goods. The difference is that the impact is on the services area of the current account (or invisibles) rather than the merchandise trade area.

This is a complex matter which requires careful analysis before any conclusions can be drawn and may see different outcomes in different countries. While freight payments under a cabotage regime may stay in the domestic economy there may be significant outflows of funds associated with maintaining a coastal fleet. Such outflows might arise from the need to import ships and parts, to obtain overseas finance for ship purchase and to import fuels.

Conversely while foreign ships may receive freight payments when engaging in coastal trades they will also provide inflows through payments towards port costs, fuel purchase and victualing.

Also relevant is that investment tied up in a domestic coastal fleet may be used to generate more efficient balance of payments accounts outcomes if invested in other sectors of the economy.

The issue of balance of payments objectives generally as they relate to international shipping services have been examined in greater detail in Chapter 4

Safety and environment arguments

An argument commonly raised by defenders of cabotage is that any replacement of domestic shipping with possible sub-standard foreign shipping will increase the risk of marine incidents on the coast and the possibility of pollution and damage to the coastal marine environment.

The difficulty with this argument is that the same ships can transit the same coastal waters with the same attendant risk on international voyages. In any event such vessels are subject to the normal processes of Port State Control whether they are on international or coastal voyages.

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ANNEXURE II

INDIA'S COMMITMENTS AT GATS NEGOTIATIONS

INDIA'S COMMITMENTS AT GATS NEGOTIATIONS

(Extract from country report)

The Commitments in Maritime Transport are made in accordance with the General Agreement on Trade in Services. All commitments are subject to domestic laws, entry requirements, rules and regulations and the terms and conditions of the Directorate General of Shipping, Reserve Bank of India and any other competent authority in India.

Modes of supply: 1) Cross-border supply 2) Consumption abroad
 3) Commercial presence 4) Presence of natural persons

Sector or sub-Sector	Limitations on market access	Limitations on national treatment	Additional commitments
<p>MARITIME TRANSPORT SERVICES.</p> <p>International Transport (Freight and passengers excluding cabotage and off-shore transport as defined in Annex 'A')</p>	<p>(1) (a) Liner shipping :</p> <p>at least 40% of cargo carried by liner shipping companies must be reserved for Indian Flag ships.</p> <p>- Preference will be given to Indian Flag vessels for government cargoes, exports from Indian on CIF/C&F and imports into India on FOB/FAS basis. Indian Flag vessels will have the first right of refusal for carrying such cargo and only thereafter can foreign flag ships be allowed to be unchartered/taken on international rental basis. Shipping arrangements for Government owned and controlled cargo will be made by Transchart Division of Ministry of Surface Transport.</p> <p>- Foreign shipping companies are obliged to appoint Indian companies as general agents or have jointventure shipping companies with Indian companies to supply maritime agency services. Non-shipping companies can do so only by opening a regional office in India.</p> <p>(1)(b) Bulk and other international shipping</p> <p>- the transportation of crude oil, and of basic oil by products is to be carried out by Indian Flag vessels</p>	<p>(1)(a) In liner trades (Not restricted to liner conference trades) between India and such countries which are contracting partners to the Un Convention on a code of conduct for liner conferences, Indian shipping lines (non necessarily national shipping lines) have a preferential right over cargo.</p> <p>- Select liner routes have been reserved for 3 national lines.</p> <p>(b) Non, except that preference will be given to public sector undertakings for shipment of crude oil, petroleum products and by-products.</p>	<p>Access to and use of Port facilities</p> <p>No. measures shall be applied to the following services which deny reasonable and non-discriminatory access to international maritime transport suppliers</p> <ol style="list-style-type: none"> 1. Pilotage 2. Towing, tug assistance and pushing. 3. Provisioning, fuelling and watering. 4. Garbage collecting and ballast waste disposal. 5. Port captain services 6. Navigation aids 7. Shorebased operational services essential to ship operations, including communications, water and electrical supplies. 8. Emergency repair facilities. 9. Anchorage, berth and berthing services.

	<p>preference will be given to Indian Flag vessels for government cargoes, exports on CIF/C&F and imports on FOB/FAS basis. Indian flag vessels have the first right of refusal for carrying such cargo and only thereafter can foreign flag ships be allowed to be chartered/taken on international rental basis. Shipping arrangements for Govt. owned and controlled cargo will be made by Transchart Division of Ministry of Surface Transport.</p> <p>Foreign shipping companies are obliged to appoint Indian companies as general agents or have jointventure shipping companies with Indian companies to supply maritime agency services. Non-shipping companies can do so only by opening a regional office in India.</p>	
	(1)(c) Passenger: None	(1)(c) None
	(2) None	(2) None
	(3)(a) For operating a ship or a fleet under the Indian flag, it is necessary to establish a registered company, or a cooperative society under and Central Act or State Act having its principal place of business in India. This is in accordance with the provisions of the Indian Merchant Shipping Act (MSA), 1958. An Indian registered vessel can ply only if it has a licence issued under the MSA.	(3)(a) None, except for registration of ship and issue of licence under the Merchant Shipping Act.
	(3)(b) Other forms of commercial presence for the supply of International Maritime Transport Services (as per definitions): Unbound.	(3)(b) None
	(4)(a) Ships crews: Unbound	(4)(a) Unbound
	(4)(b) Key shore personnel: Unbound	(4)(b) Unbound
MARITIME AUXILIARY SERVICES		
Maritime Cargo Handling SERVICES	(1) Unbound (2) None (3) Unbound (4) Unbound	(1) Unbound (2) None (3) Unbound (4) Unbound
Storage and Warehousing Services in Ports	(1) Unbound (2) None (3) Unbound (4) Unbound	(1) Unbound (2) None (3) Unbound (4) Unbound

Customs Clearance Services	(1) Unbound (2) None (3) Unbound (4) Unbound	(1) Unbound (2) None (3) Unbound (4) Unbound	
Container Station and Depot Services	(1) Unbound (2) None (3) Unbound (4) Unbound	(1) Unbound (2) None (3) Unbound (4) Unbound	
Maritime Agency Services	(1) Unbound (2) None (3) Unbound (4) Unbound	(1) Unbound (2) None (3) Unbound (4) Unbound	
Maritime Freight Forwarding Services	(1) Unbound (2) None (3) Unbound (4) Unbound	(1) Unbound (2) None (3) Unbound (4) Unbound	
International rental/charter of vessels with crew or on bareboat basis (excluding cabotage and offshore transport)	(1) Unbound (2) None except obtaining permission from Director General (Shipping) for chartering a foreign flag vessel in the absence of availability of a suitable Indian vessel (3) Unbound (4) Unbound	(1) Unbound (2) None, except vessels rented by Indian nationals are considered as foreign vessels (3) Unbound (4) Unbound	
Maintenance and repairs of seagoing vessels	(1) Unbound (2) None (3) Unbound (4) Unbound	(1) Unbound (2) None (3) Unbound (4) Unbound	

**LIST OF ARTICLE II (MFN) EXEMPTIONS ON MARITIME
TRANSPORT SERVICES**

Sector or subsector	Description of measure indicating its inconsistency with Article II	Countries to which the measure applies	Intended duration	Conditions creating the need for the exemption
SHIPPING				
(a) Cargo sharing between bilateral partners	Equality in freight lifting originating in the ports of partners to the agreement and equality in freight earnings.	Bulgaria, United Arab Republic, Poland, Russian Federation and any other countries with which a bilateral shipping agreement is entered into in future.	Indefinite	In the context of overall trade relations.
(b) Cargo Reservations	Cargo reservation under the UN Code of Conduct for Liner Conferences. Sharing of cargo between the shipping lines of contracting states and third-country lines in the ratio of 40:40:20 as provided in the Liner Code.	All countries which are contraction parties to the UN Convention. All countries with which Double Taxation Avoidance agreements are signed.	Indefinite	To fulfil obligations under the convention.
(c) Avoidance of double taxation	On income and capital of a non-resident person earned in India from the operation of a ship engaged in International Maritime Transport on the basis of reciprocity with the country in which the person resides.		Indefinite	Maintenance of reciprocity as the basis of tax exemption.

DEFINITIONS

1. **“International Transport (Freight and Passengers)”**, for the purpose of this schedule, is to mean transportation of international Maritime Freight and Passengers by sea going vessels from the port of loading in ore country to the port of discharge in another country.
2. **Cabotage:** This Schedule does to include any commitments on “Cabotage” or “Maritime Cabotage Transport Services” which are described as transportation of passengers or goods between any port located in India and any other port also located in India and traffic origination and terminating in the same port located in the country and further includes transportation of passengers or goods between a port located in India and installation and structures situated on the continental shelf of India.
3. **Offshore Transport:** for the purposes of the schedule only, “Offshore Transport” refers to shipping services involving the transportation of passengers or goods between a port located in India and any location, installation or structure associated with or incidental to the exploration or exploitation of natural resources of the continental shelf of India, the seabed of the Indian coastal seas and the subsoil of the seabed, or situated on the continental shelf of India.
4. **“Other forms of Commercial Presence for the supply of International Transport Services”** means ability for International Maritime Transport Service Suppliers to undertake local activities which are necessary for the supply to their customers of a partially or fully integrated transport service, within which maritime transport constitutes a substantial element.

These activities include, but are not limited to:

- marketing and sales of maritime transport and related services through direct contact with customers, from quotation to invoicing, these services being those operated or offered by the service supplier itself or by service suppliers with which the service seller has established standing business arrangements;
- b. acquisition on their own about or on behalf of their customers (and the resale to their customers) for any transport and related services, including anchorage, berth and berth services, and onwards transport services by any mode, particularly road and rail, inland waterways, necessary for the supply of the integrated services;
- c. the preparation of transport documents, customs documents, or other documents related to the origin and character of goods transported;
- d. the provision of business information, including computerised information systems and electronic data interchange;
- the setting up of business arrangements with any locally established shipping agency and the appointment of personnel recruited locally (or, in the case of foreign personnel, subject to horizontal commitments on movement of personnel);
- f. organising any aspect of the call of the vessel or taking control over cargoes;
- g. the provision of Ships Managers’ Services.

NOTE : In order to enforce certain standards and conditions which need to be fulfilled by shipping service suppliers, particularly those providing ship personnel and crew and also those engaged in providing ships management services, and to ensure that the owner, operator, agent or manager has:

the capability of implementing international standards as well as IMO stipulations and recommendations;
the necessary financial structure so that he is responsible and accountable;
the capability of implementing, the safety; and marine pollution controls;
fulfilled requirements of quality management and his operations are transparent;
a system of registration/licensing of shipping service supplier is under consideration in India.

5. **“Ship Managers”** means persons entering India as the agents or representatives of a ship’s owner or operator for the purposes of assessing requirements, negotiating and authorising expenditures necessary to the maintenance and operations of a vessel as well as the Handling of Cargo.
6. **“Maritime Cargo Handling Services”** means activities exercised by stevedore companies, including terminal operators, but not including the direct activities of dock workers, when this workforce is organised independently of the stevedoring or terminal operator companies. The activities covers, include the organisation and supervision of:
the loading/discharging of cargo to/from a ship;
the lashing/unlashing of cargo;
the reception/delivery and safekeeping of cargoes before shipment or after discharge.

The organization and supervision includes the arrangements for (1) engaging skilled workers (dockworkers), (2) using all necessary equipment for on board or shore use and appropriate storage space, whether by ownership, rental or otherwise, (3) the checking of parcels and markings, the weighing and measuring of cargo, and (4) the administrative duties and responsibilities related to the services.

7. **“Maritime Freight forwarding Services”** means the activity of organising and monitoring shipments on behalf of shippers through providing such services as the arrangement of actual transport and related services, consolidation, aggregation, packing of cargo, preparation of documentation and provision of business information.
8. **“Maritime Agency Services”** means activities in representing, within a given geographic area, the business interests of one or more shipping lines or shipping companies for the following purposes:

marketing and sales of maritime transport and related activities from quotation to invoicing (cargo booking and canvassing);
marketing and sales of maritime transport and related activities from quotation to invoicing (cargo booking and canvassing);
issuance of bills of lading on behalf of the companies;
acquisition and resale of other necessary related services (settlement of disbursements and claims) preparation of documentation, and provision of business information;
acting on behalf of the companies in organising the call of the ship or taking control of cargoes;
to make arrangements in order to get all necessary port services required by the foreign vessel during its stay in Indian ports;
to appoint a stevedoring company for cargo loading and unloading on behalf of its principal;
to collect freight on behalf of the principal.

9. **“Customs Clearance Services”** (alternatively Customs House Agents/Brokers) means activities consisting of carrying out on behalf of another party customs formalities concerning import export or through transport of cargoes irrespective of whether this is the main or secondary activity of the service provider.
10. **“Government Cargo”** means cargo originating from other countries (import cargoes including crude oil), petroleum by products, coal, natural gas, raw materials for fertilizers, food-grains, etc.) purchased by Indian government Agencies/Departments or based on loan/credit agreements with other countries, as well as exports by Indian government Agencies/Departments including Government aid.
11. **“Container Station and Depot Services”** means activities consisting of storing containers, whether in port areas or inland, with a view to their stuffing/stripping, repairs and making them available for shipments.
12. **“Maintenance and Repairs of Vessels”** means services such as repairs, management of vessels, mending, fixing or overhauling of a vessel, management of crew and marine insurance, provided on behalf of a maritime passenger or cargo transport business, or vessel leasing business.
13. **“International rental of vessels with crew or on bare-boat charter basis”** means rental and/or leasing services of all types of sea-going vessels with crew or on bare-boat basis (whether the ship will be manned by Indian nationals only during the period of rental/least) for the purposes of international trade (like tankers, dry bulk cargo vessels, cargo and freight vessels, etc).